1990 TAX RETURN FILING SEASON AND THE ADMINISTRATION'S FISCAL YEAR 1991 BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

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1990 TAX RETURN FILING SEASON AND THE ADMINISTRATION'S FISCAL YEAR 1991 BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE

THURSDAY, MARCH 22, 1990

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:36 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
THURSDAY, MARCH 15, 1990

PRESS RELEASE #24
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
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THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A HEARING ON THE 1990 TAX RETURN FILING SEASON AND
THE ADMINISTRATION'S FISCAL YEAR 1991 BUDGET PROPOSALS
RELATING TO THE INTERNAL REVENUE SERVICE

The Honorable J. J. Pickle, (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a hearing to review the 1990 tax return filing season and to examine the adequacy of the Administration's fiscal year 1991 budget proposals relating to the staffing levels and allocation of resources for the Internal Revenue Service (IRS). In addition, the Subcommittee will review the impact of fiscal year 1990 funding shortfalls on current IRS operations.

The hearing has been scheduled for Thursday, March 22, 1990, beginning at 9:30 a.m., in the main Committee hearing room, 1100 Longworth House Office Building. Witnesses invited to appear at the hearing include: the Honorable Fred T. Goldberg, Jr., Commissioner of the Internal Revenue Service; Jennie S. Stathis, Director, Tax Policy and Administration Issues, U.S. General Accounting Office; and, Howard G. Rhile, Jr., Associate Director, Information Management and Technology Division, U.S. General Accounting Office.

The Subcommittee will review the status of the 1989 tax return filing season, including:

- the availability and accuracy of taxpayer assistance, focusing on the telephone assistance program (IRS has shown improvement this year, in comparison to last year where only 63 percent of the answers provided to taxpayers were correct. However, this year taxpayers are experiencing more difficulty reaching a telephone assistor.);
- the preparedness for the filing season, including the availability of tax year 1989 forms and instructions (Almost 900,000 forms and instructions were backordered, as of February 22, 1990, at IRS form distribution sites. This is 700,000 more backorders than reported in February, 1989.);
- the status of IRS workload inventory levels, focusing on tax returns received, returns processed, and refunds issued (IRS reports that the average refund, as of February 23, 1990, is $868, which compares to an average refund of $825 in February, 1989.); and,
- emphasis on new computer projects intended to reduce unpostables and improve telephone accuracy, and the utilization and capacity of IRS computer equipment, focusing on the electronic filing system which will be implemented this year on a nationwide basis.

The Subcommittee will consider the adequacy of the Administration's fiscal year 1991 budget proposal relating to the IRS (which totals $6.135 billion and 118,759 positions), including:

- whether an increase of $635 million (11 percent) and 3,667 positions (3.2 percent) in fiscal year 1991 over fiscal year 1990 levels is sufficient to process 192 million tax returns, assist 80 million taxpayers, collect $1.1 trillion in net tax revenues, examine 1.25 million income tax returns and 14,700 exempt organization returns, issue 252,000 employee plan determination letters, modernize IRS computer systems, increase resources for IRS inspection, enhance money laundering and narcotics trafficking investigations, and increase audit activity of U.S. subsidiaries of foreign corporations;

- how fiscal year 1991 revenue initiatives will impact on IRS operations, and what specific programs will be undertaken with the increased enforcement funding initiative and the management reform initiative, including the types and number of tax shelter cases that will be closed;

- whether the IRS is making sufficient progress in its efforts to overhaul and modernize its computer systems; and,

- what additional programs could have been implemented if the Administration had submitted to the Congress the budget which was requested by the IRS, totalling $6.37 billion and 119,841 positions (an additional $235 million and 1,082 positions).

In addition, the Subcommittee will examine the impact the $470 million fiscal year 1990 budgetary shortfall, and the continuation of the fiscal year 1989 hiring freeze, have on current IRS operations, including:

- cutbacks in IRS training programs, notably tax examiner training on recent tax law changes;

- staffing reductions in the Automated Collection System, while the amount of delinquent taxes owed to the IRS by taxpayers exceeds $87 billion;

- a decrease in the examination rate, which was originally projected at 1.23 percent and is now projected at 1.02 percent (i.e., 250,000 fewer returns that will be examined); and,

- cutbacks in travel which have caused district offices to select some types of returns for examination based on the location of the taxpayer rather than on noncompliance or the greatest potential revenue yield.

In announcing the hearing, Chairman Pickle stated: "The Administration has proposed an increase in IRS funding of $635 million for fiscal year 1991, in comparison to this year. I am pleased to see that the Administration recognizes the importance of providing the IRS with the funding and staffing needed to do a quality job.

"The public and the Congress expect the IRS to efficiently and fairly collect the country's taxes, and also to provide accurate and timely assistance to taxpayers nationwide. If IRS is to be run like a successful business, it has to have adequate resources and staff.

"I look forward to asking the Commissioner for a realistic assessment of what IRS's financial picture looks like this year, and what the IRS can accomplish under the Administration's budget proposal."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written comments for the printed record of the hearing should submit six (6) copies by the close of business, Friday, April 20, 1990, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will **not** be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

Chairman PICKLE. The subcommittee will come to order.

Today, the subcommittee meets to review the 1990 tax return filing season. I am pleased to say the filing season appears to be going fairly smoothly. For the past 2 years, I have been troubled by the low accuracy rate of the Internal Revenue Service's telephone taxpayer assistance program. The good news is that this year you stand a much better chance of getting a right answer from the IRS. The bad news is that you also stand a better chance of getting a busy signal. Last year, the accuracy rate was about 63 percent. This year, it is up to 76 percent. So that is good. A 1 in 4 chance of getting a wrong answer still is not good enough, but at least it is a step in the right direction.

In addition, the subcommittee will consider the adequacy of the administration's fiscal year 1991 budget request for the IRS. While the budget provides for an 11-percent increase in IRS funding, it still appears that there are areas that may deserve further attention. I am troubled, for example, by decreases in staffing in exempt organizations and employee plans and in taxpayer service. Especially troubling is the estimated audit rate of only 1 percent. The fact is that we ought to have a meaningful audit rate. In the past few years, it has been declining and declining and declining. Before long, we may not have any audits. If this decline in the audit rate does not stop, Mr. Commissioner, Congress may be forced to mandate minimum audit levels. We are taking steps in that direction now in the Customs area. Yesterday we imposed a funding floor for commercial operations.

As part of our budget review, the committee will look at the adverse impact on the IRS operations of the current 1990 $470 billion budgetary shortfall.

Finally, the subcommittee will hear testimony about the efforts to replace IRS's outmoded computer system. A tax system as massive and complex as ours is increasingly dependent on computers and the electronic transmission of data. The system in use now, based on 1960's technology, depends heavily on paper. The effort to replace it will be a massive one. It will span several years, cost billions of dollars, and require state-of-the-art technology. It is one of the largest, if not the largest, modernization efforts ever undertaken by a nondefense Federal agency.

I think it is important, then, that the subcommittee be kept informed of the progress in this area, and we will ask that you so do that.

To implement all of this, we need to collect more money or to appropriate more money. Something must be done to further improve our tax system.

Now, I am going to ask Mr. McGrath if he would like to make a statement. Mr. Schulze will not be able to be with us this morning.

Mr. MCGRATH. Thank you, Mr. Chairman.

Mr. Chairman, I am pleased to join you in opening our hearing on the fiscal year 1991 budget of the Internal Revenue Service and the 1990 tax filing season.

The administration budget funds the IRS with $6.1 billion for the fiscal year 1991. This is almost 12 percent higher than fiscal year 1990. This will allow the Service to increase its personnel base to

over 118,000 employees, or 3,700 more persons than it currently employs.

This represents a sizable increase in the resources for the IRS. The size of the increase appears to be far in excess of the normal COLA-type adjustment.

There are several points which we must examine today. First, where are the additional resources going to be applied? Over half of the additional resources are earmarked for tax law enforcement and information services. In contrast, taxpayer assistance receives only a modest increase. We should examine the IRS budget to determine if the $635 million increase has been distributed in the most efficient manner.

A second point is to examine the interplay between the $635 million increase for the fiscal year 1991 and the $470 million shortfall in 1990. As you remember, the IRS was forced to absorb $470 million in cuts for its fiscal year 1990 budget because of the pay increase, higher contributions for health insurance premiums and retirements, and the sequester. Therefore, part of the $635 million increase really may be going to offset the effects of the 1990 cut. We should examine how much of the $635 million represents a true increase in resources and how much is backfilling what was cut in the 1990 budget.

The 1990 tax filing season appears to be going very smoothly, but I am sure we will all breathe a little easier after April 15.

The IRS has processed 15 percent more returns so far this year than in 1989. Taxpayers are making fewer mistakes, and the average refund is $864. Unfortunately, taxpayer assistance remains a point of attention. The accuracy rate of the IRS telephone assistance is reported to be 76 percent. This accuracy rate is better than last year, but it is still far below our expectations. What has the IRS done to recruit and train qualified taxpayer assisters?

Finally, the number of returns filed electronically has tripled since last year. This trend helps the IRS to operate more efficiently, but it may not be advantageous to all taxpayers who have a refund coming. Persons who file electronically generally receive their return in 2 weeks versus 6 to 8 weeks for the normal paper return. Private tax services charge about $35 to file electronically.

This charge is over and above the cost of preparing the return itself. For a person with an average refund of $864, the $35 service fee represents an annualized interest rate of 35 percent. For lower refunds, the annualized interest rate is even higher. A taxpayer should have a return of several thousand dollars coming in order to make it attractive to pay the $35 in order to hasten his return check by 6 weeks. I doubt most persons evaluate the economics of the $35 service fee as it applies to the size of the refund.

Mr. Chairman, there are many budgetary and operational practices of the IRS which we will examine today. They are all important, and I trust we can identify both their strong points as well as their weak points.

Thank you, Mr. Chairman.

Chairman PICKLE. Well, thank you, Mr. McGrath.

Does any other member wish to make any kind of statement at this time? Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman. I just have one inquiry I would like to make of Mr. Goldberg. During our last hearing regarding the IRS I got into a series of questions about which Federal agencies were not complying with tax law and what were your accounts receivable inventory list of $100 million or more. And I have gone through my briefing papers preparing for this hearing today, and I do not see that we have received that information. So I would hope that in your oral presentation you could explain what the status is, and if not, we will get into it in the question and answer part.

Chairman PICKLE. Mr. Ford.

Mr. FORD. Thank you very much, Mr. Chairman. I had mentioned to you earlier that I would have to leave, but I am very pleased to join with you and other members of this Subcommittee on Oversight, and also to welcome Commissioner Goldberg back to the committee.

I would like to ask unanimous consent to revise and extend my remarks, and I will submit them for the record. I also would just like to mention, Mr. Chairman, as we approach the middle of this tax filing season, we think about your statements made regarding the outmoded computer system that is set up throughout the Internal Revenue Service. I certainly look forward to the day that hopefully Memphis will have not only the state-of-the-art computer system, not pilot but a center that will demonstrate to the rest of the centers throughout this Nation that we, in fact, in the next decade will make significant progress in responding to the taxpayers of this country.

With that, Mr. Chairman, I close out.

[Mr. Ford submitted the following:]

STATEMENT SUBMITTED BY CONGRESSMAN HAROLD E. FORD
BEFORE
SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS
ON
1990 TAXPAYER FILING SEASON

I am pleased to have Commissioner Goldberg join us today to discuss the 1990 taxpayer filing season. I am particularly interested in the Internal Revenue Service's analysis of its progress as we look at the IRS fiscal year budget proposal for 1991 and the current efficiency of the Service's filing season operations.

The IRS expansion and modernization of facilities and equipment, efficiency in the processing of returns, and the budget constraints that will determine where IRS resources will be allocated nationwide, are all issues that affect my Congressional district. Currently the IRS Memphis Service Center has a permanent staff of over 4200 during the peak filing season and 2700 during the remainder of the year. In addition a new facility will be built in Memphis where employees will be relocated from the facility currently located near the Memphis-Shelby International Airport. Any expansion of operations or modernization of IRS equipment will not only effect the efficiency of the IRS during the peak filing seasons, but will also have a community impact, particularly if such expansion increases the IRS workforce in Memphis.

In my letter to the Commissioner last month concerning the relocation of one of the Memphis IRS facilities, I inquired as to whether centralization of facilities was one of the long-term goals of the IRS. In a response letter from the IRS I was told "consolidation" is the goal of the IRS. I am interested in knowing how IRS plans to reach its goal of consolidation in Memphis. I am also interested in learning more about how modernization of current systems and updated technology for processing fit into the Service's scheme for consolidation of their operations and facilities in Memphis. I will carefully review the Commissioner's testimony from today's hearing in hope that I will learn more about the Service's long reaching goals for their operations nationwide as well as Memphis.

Another issue that is of particular concern to me is the utilization of the earned income tax credit (EITC). The credit has been underutilized by low-income families eligible to receive the credit. According to information provided by the Children's Defense Fund, many low-income families that historically have not filed income tax returns are not knowledgeable of their eligibility for the EITC. While the IRS has a system automatically correcting errors by taxpayers in the amount of EITC owed to them, there is no mechanism to get non-filing parents into the system to receive the credit available to them. It is also disturbing that errors in assessing the EITC is one of the most common taxpayer filing errors this year. I want to know more about the Service's plans for better dissemination of information to the public concerning the use of the credit. With the proposed expansion of the EITC in the child care bill, the increase in taxpayers eligible for the credit will make accuracy in filing for rightful recipients of refunds an issue of top priority for for low-income families.

In examining the progress report on the 1990 filing season overall, the preliminary evidence indicates that taxpayer services have generally improved in the past year. The continued investigation by the Oversight Subcommittee has kept the pressure on the Service and shows some positive results. I applaud Chairman Pickle and the Subcommittee staff for their ongoing review. It is my hope that as IRS service centers mcdernize their equipment for more efficient processing, the Memphis service center will receive a high priority.

****

Chairman PICKLE. Mr. Dorgan.

Mr. DORGAN. Thank you, Mr. Chairman.

I would like to pursue a couple of areas this morning, and I welcome the Commissioner and tell him, as a former tax commissioner myself, I am interested in helping. I would like to see the Internal Revenue Service succeed and do the best job they can.

I am concerned, and have been concerned for a long while, about centralization. Centralization means that in North Dakota they say, well, we are going to move your assistance to Minneapolis, and when you all need assistance, you just call them up. The question is that when you call, are you going to get an answer, or are you going to get a busy signal? And there are some numbers about the diminished level of support there that concern me.

Second, I am concerned about the growth in the accounts receivable and the diminished number of collectors to deal with it, over $80 billion, $40 billion of which might be really collectible at this point.

Third, I would like to pursue as well Mr. Anthony's issues on the Federal agencies that we discussed previously.

Finally, Congress, it seems to me, bears some responsibility for the complexity of these tax laws that we have and the resulting tax returns. And as we discuss all of these issues today, one of the things that we ought to understand is that the American people are choking—at least those that don't file short forms are choking on the complexity of the income tax law, and we have got to find a way to address that.

Chairman PICKLE. Thank you, Mr. Dorgan.

Commissioner Goldberg will be our first witness. He is the Commissioner of the Internal Revenue Service.

Mr. Goldberg, now that all the members have welcomed you and expressed their grave concern about things you have yet to discuss, we recognize you and appreciate the fact that you are here. We appreciate the work that you and Mike and others are doing down at the Internal Revenue Service.

You have a statement prepared, and we will be glad to receive it. I understand you are going to follow the script of your comments. Do we all have copies of this?

Mr. GOLDBERG. Yes, sir, you do.

Chairman PICKLE. All right. Well, we are glad to have you here, and we welcome you.

STATEMENT OF HON. FRED T. GOLDBERG, JR., COMMISSIONER OF INTERNAL REVENUE, U.S. INTERNAL REVENUE SERVICE, ACCOMPANIED BY MICHAEL J. MURPHY, SENIOR DEPUTY COMMISSIONER; CHARLES BRENNAN, DEPUTY COMMISSIONER FOR OPERATIONS; JOHN JOHNSON, DEPUTY COMMISSIONER FOR PLANNING AND RESOURCES AND CHIEF FINANCIAL OFFICER; HANK PHILCOX, CHIEF INFORMATION OFFICER; ROBERT LeBAUBE, ASSISTANT COMMISSIONER FOR TAXPAYER SERVICE; AND CHARLES PEOPLES, ASSISTANT COMMISSIONER FOR RETURNS PROCESSING

Mr. GOLDBERG. It is a pleasure to be here. I am tempted to say that I agree with everything you and your colleagues have said and shut up, but the way these things work, I will give my statement.

I am pleased to be here today to discuss the 1990 filing season and the 1991 budget. With me today are Mike Murphy, Senior Deputy Commissioner; Charley Brennan, our Deputy Commissioner—Operations; John Johnson, our Deputy Commissioner—Planning and Resources/Chief Financial Officer; Hank Philcox, Chief Information Officer; Bob LeBaube, Assistant Commissioner--Taxpayer Service; and Charlie Peoples, Assistant Commissioner—Returns Processing.

Mr. Chairman, this appearance before your subcommittee is particularly satisfying because I have two relatively straightforward and encouraging messages to deliver. In each case, I believe that you and your colleagues deserve a fair share of the credit for the good news.

First, the filing season to date has gone exceptionally well. Our ongoing investments in quality and technology are paying off, much to the benefit of the taxpaying public.

Second, while our budgetary shortfalls of the past 2 years have imposed, and will continue to impose, great costs in terms of lost revenue and reduced levels of service, we now see light at the end of the tunnel. The President's 1991 budget request is a good and a necessary beginning. If enacted, it will mark the start of a much needed, long-term investment in the health of our tax system.

As a preliminary matter, I should point out that April 15th has not yet come and gone. We are working hard to manage our old systems, and we may still hit a few more potholes. I only hope that all the good news I am about to lay out here won't jinx the next 3 or 4 weeks.

The plain fact is that we are in the midst of a successful season. Taxpayers are filing earlier this year. As of March 9, we had received 44.8 million returns, a 3.5-percent increase over last year at this time. We are also processing returns much more quickly this year. Again, as of March 9, we had processed almost 33 million returns, a 12.5-percent increase.

In my opinion, these positive developments reflect a number of factors, including: continued improvements in the quality of our processing efforts, improved forms distribution, our close working relationship with tax professionals, electronic filing, and enhanced quality in our taxpayer service program. In addition, I would like to single out for credit the 90,000 volunteers in our VITA and Tax Counseling for the Elderly programs. These folks will assist almost

4 million taxpayers in completing their returns this year. I would also like to express thanks to the Ad Council and to the news media for their support of our File Early/Make Taxes Less Taxing Campaign.

Mr. Chairman, this is the 20th anniversary of our volunteer tax assistance program. We owe special thanks to the hundreds of thousands of individuals and businesses throughout this country for their support over the years.

The quality of our processing efforts and the quality of the returns we are receiving from taxpayers and tax professionals are showing marked improvement over last year. There have been significant improvements in almost all of our measures of things gone wrong when compared to the same items last year:

The number of unpostables are down 15 percent. Entity cases are down 18 percent. Rejects are down 31 percent. Unidentified remittances are down 27 percent. Blocks out of balance are down 19 percent. The overall error rate has declined from almost 16 percent to under 14 percent.

Now, these words may not mean very much, but the concepts do. They all reflect the cost of poor quality. When quality goes up, these indicators go down. Taxpayers and the Service are doing it right the first time, and doing it right the first time means fewer delays in refund checks, fewer erroneous or unnecessary taxpayer contacts, and fewer needless hassles with the IRS.

Without question, these improvements are the direct result of our continuing emphasis on quality and our investment in systems modernization. And they are a tribute to the hard work, dedication, and skills of employees and managers throughout the Service.

As you noted, there are two sides to the story in taxpayer service this year. On the one hand, our accuracy rate has improved substantially over last year, from 61.4 to 76.2 percent. On the other hand, there has been a significant decline in our level of service, from 84 percent last year to 71 percent this year. The former reflects our continuing emphasis on quality and our investment in systems modernization; the latter reflects the impact of our 1990 budget shortfall.

Mr. Chairman, as we have said on many occasions, taxpayers are entitled to correct answers from the IRS every time they call. Perfection is the only acceptable goal for this agency in everything we do. At the same time, however, I think all of us can take enormous pride in the significant improvement in our accuracy rates this year. It reflects our continued emphasis on training, our use of more effective research materials, the fine work of our diagnostic centers, and our technology-based experiments in Boston and Dallas; above all, it reflects the dedication and skills of our taxpayer service employees and managers.

While our progress is noteworthy, we can, and should, do much better again next year. We have learned a great deal from the progress we have made and are already developing strategies to improve our performance again during 1991. With respect to the factors we control, I am optimistic. At the same time, however, taxpayers and the IRS alike are victims of needless and burdensome complexity in the tax law. To give but two examples, when our assisters must ask as many as 42 probing questions to correctly

answer a taxpayer's question on the definition of head of household, and as many as 13 probing questions are required to answer a question on whether someone is required to file a return, we are all in trouble. Until we achieve greater simplification, particularly as it affects low- and middle-income taxpayers, our accuracy rates will continue to suffer.

With respect to level of service, two points are worthy of note. First, as I will describe shortly, we made a conscious decision this year to reduce our level of service to 75 percent as part of our overall efforts to deal with the 1990 budget shortfall, stemming largely from sequester and pay raise absorption. Second, as you know, our level of service depends on actual demand relative to projected demand. Actual demand is running 7 percent ahead of our projections, causing our level of service to decline to approximately 71 percent this year. The plain fact is we will answer 2.4 million fewer calls this year, and taxpayers will endure more busy signals. I should note that our average time per call has remained constant, confirming our view that we can enhance quality and maintain productivity at the same time. I should also point out the number of individuals served at our walk-in taxpayer service offices will increase by approximately 7 percent this year.

Before turning to electronic filing, I would like to mention the taxpayer service projects we have underway in Boston and Dallas. As you know, the Boston effort involves the use of computers and expert systems that guide our assisters to correct answers. The Dallas effort equips our assisters with computerized research materials. In each case, we believe these efforts are generating significant improvements in quality.

While many of us are extremely enthusiastic about their long-range promise, I want to emphasize that these efforts are just getting started. We have a great deal to learn. We must be particularly sensitive to the human side of the equation: As we pursue these technologies, we must provide proper training and work with the National Treasury Employees Union to assure enhanced job satisfaction and professional opportunities for all of our affected employees.

We have made no final decisions with respect to expanding these projects to additional call sites. At the present time, however, we anticipate during the 1991 filing season 3 of our 31 call sites will implement comprehensive pilot projects. These pilot projects will incorporate techniques from both the Boston and Dallas experiments and will also automate a number of related taxpayer service functions. In addition, we will place the expert system in approximately four additional call sites. At the same time, of course, we will build on our experience this year to improve the quality in the remaining 24 locations. We believe this strikes a proper balance between the need to enhance and improve the way we do business with our need to learn more about the human equation of new information systems we are introducing. We must also contend with budgetary constraints, the procurement nightmare, and practical limits relating to site configuration, power constraints, and the like.

Electronic filing became available on a nationwide basis for the first time this year. The program has been an overwhelming suc-

cess, and the numbers speak for themselves. We projected almost 2 million returns for the filing season. We have more than 3.5 million returns to date, and the number grows daily. More than 92 percent of the refunds for electronically filed returns have been issued within 3 weeks after receipt. More than 98 percent of the refunds for electronically filed returns have been issued within 4 weeks after receipt. More than 82 percent of the taxpayers who have filed electronically have opted for direct deposit of refunds, effectively shaving a week off the refund timetable for those taxpayers. Only 40,000 refunds out of a universe of 3.5 million have taken more than 4 weeks to issue, and all of these refunds have been issued in less than 10 weeks.

Now, faster refunds are certainly an important part of the story, but many of us believe that quality improvement is an equally important aspect of electronic filing. The error rate associated with our paper returns—for example, math errors, our own transcription errors and the like—is running at approximately 14.6 percent this year. While this represents an improvement over prior years, the error rate for electronically filed returns is less than 5 percent.

Of equal importance, errors associated with electronically filed returns are generally identified early in the process and are almost always resolved within a matter of days after filing. Unfortunately, our current systems are such that errors associated with paper returns may not be resolved for months. In the meantime, costs and frustration levels continue to rise for taxpayers and the IRS alike.

While much of the public focus has been centered on the time it takes to process a return and issue a refund, electronic filing demonstrates how our modernization efforts will improve our work in other ways. Another feature of electronic filing, for example, is the ability to call up a copy of the complete return—whether requested by the taxpayer or an IRS employee—in far less time than it currently takes to requisition and obtain a paper return which has been stored in a Federal records center. The ease and quickness of printing a hard copy of an electronically filed return will significantly improve our responsiveness to taxpayers as well as IRS offices that need that return.

While electronic filing is exceeding our expectations this year, we have encountered a number of problems. There was a breakdown of certain procedures in a tape shipment from Cincinnati to our computer center in Martinsburg that resulted in a 2-week delay in issuing refunds. A tape that was shipped from Ogden to Martinsburg was damaged, resulting in a 1-week delay. Certain taxpayers with changed filing status, such as a name change, married or divorced, could experience refund delays of several weeks. Treasury has encountered a number of unanticipated processing errors that have delayed several thousand refunds.

As a practical matter, these difficulties are quite minor in the context of the overall program. Of equal importance, they are not problems occasioned by electronic filing. Most were caused by our older processing systems. These very same occurrences caused similar delays for taxpayers who had filed paper returns. As we make progress in modernizing our systems, that progress will preclude these problems from occurring.

I also want to emphasize that the electronic filing program is still in its infancy, and significant improvements and changes will be required down the road. We need to expand electronic filing to include balance due as well as refund returns. We need to devote constant attention to security and quality control. We need to explore avenues for helping small preparers offer electronic filing services to their clients. We need to consider ways to let individuals who prepare their own returns enjoy the benefits of electronic filing. We need to determine whether we can avoid the problems inherent in shipping tapes by way of electronic hookups. We also hope and expect that market forces will dramatically cut taxpayers' costs for electronic filing in the years ahead.

We are currently refining our strategy for 1991. We are making a great deal of progress, and we look forward to sharing these plans with you, your colleagues, and the taxpaying public.

Mr. Chairman, I am going to move on——

Chairman PICKLE. Mr. Commissioner, let me ask you on that. The work we are doing on electronic filing, will that cost us more from a budget standpoint, or will we save money? Do you have any estimated figures on that?

Mr. GOLDBERG. Mr. Chairman, in the short term, you have to buy some computer equipment to do electronic filing. With respect to an ongoing basis, when taxpayers file electronically, it saves us an enormous amount of resources.

Chairman PICKLE. Please submit to the committee your estimates, the best estimates you can of how that program would work from a budget standpoint. Will you do that?

Mr. GOLDBERG. We would be happy to, Mr. Chairman.

[The following was subsequently received:]

Although the startup costs are substantial, there are both tangible and intangible benefits realized over the 12 year life of the electronic filing system. Based on our projections prior to the 1990 filing season, it will be FY 1993 before any net benefits are realized. We then project the net benefit-to-cost ratio to be 4.25 to 1 ($724 million in benefits to $191 in costs).

Mr. GOLDBERG. I am now turning to the middle of page 5.

As I have indicated, the success we are enjoying this year has many causes, ranging from our emphasis on quality and systems modernization, to the dedication and skills of our employees, and the vital role of 90,000 volunteers.

But there is another, all-important reason why the filing season has gone so well. Other than repeal of the catastrophic health care surtax, there were no last-minute law changes with current year effective dates. My personal view is that this may well be the major reason for our success.

The tax law can, should, and will change with the times. For the foreseeable future, it is likely that these changes will occur each year. But for the sake of tax administration at the Federal, State, and local level, for the sake of tax professionals and commercial preparers, and for the sake of the taxpaying public, change it early or change it with future year effective dates.

Mr. Chairman, I would now like to turn to our budget. The other focus of this hearing is our 1991 budget submission. The best way to begin is by reviewing what has taken place during the past 10

years and to describe the challenges we face during the decade of the 1990's.

Between 1981 and 1990, the number of tax returns filed will have increased from 160 to 190 million, a growth of 20 percent. The number of information documents filed will have doubled from 600 million to 1.2 billion. We will have implemented annual changes in the tax law involving an aggregate of 2,381 code sections—changes that have required substantial modifications to all of our existing forms and instructions, the creation of 81 new forms, significant annual computer programming changes, and material revamping of training programs throughout the IRS.

During that same period, there have been cumulative pay increases of approximately 40 percent, and our health and retirement costs have increased approximately 200 percent and 90 percent respectively. At the same time, we have incurred increased costs to help recruit qualified personnel in highly competitive labor markets and inflationary increases in other support costs. In addition, the cost of maintaining our outmoded and aging computer systems has started to skyrocket, and we are now investing in the long-term modernization of our systems. Last but not least, other Federal agencies, notably the General Services Administration, the National Archives and Records Administration, and the Postal Service, have passed along significant inflationary cost increases.

I don't want to get into the question of whether IRS budgets have kept pace with the foregoing. It is clear that our resources have grown significantly. Our budget increased from $2.5 billion and 84,700 staff years in 1981 to $5.5 billion and a projected 115,000 staff years for 1990. This is a 120 percent growth in nominal dollar terms and a growth in staff years of approximately 35 percent.

Much of the increase in our direct and indirect payroll costs was anticipated and appropriate; unfortunately, some of that increase was handled inefficiently or was simply not anticipated. We have accomplished a great deal in many programmatic areas; unfortunately, we have witnessed declines in productivity in our traditional enforcement functions. Some of our difficulties have resulted from the budget process itself. In other respects, the problems are clearly of our own making. The absence of steady growth rates has only made matters worse. Our budget increases fluctuated wildly during the 1980's, from a high of 14 percent in 1987, to a low for the current year of less than 3 percent.

In any case, we have experienced greater than budgeted direct and indirect payroll costs, slower than anticipated attrition, and greater than budgeted space costs and equipment maintenance costs during the past 5 years. And, Mr. Chairman, for the past 15 months, we have all been paying the piper, especially in the context of the fiscal year 1990 unbudgeted pay raise and sequestration.

We have had a partial or complete hiring freeze in most of our programmatic activities that will not be lifted for months to come; a freeze that has caused significant long-term damage to the health of our tax system.

We have had a partial freeze on promotions throughout the Service since last November; a freeze that undermines tax administration and is unfair to our employees.

We have made programmatic cutbacks that will remain in place for months to come: cutbacks that have cost, and will continue to cost, hundreds of millions of dollars in revenue; cutbacks that have reduced the level of service we are providing the taxpayers this filing season.

We also face gross structural imbalance in our budget; a continuing failure to invest in our future, a failure to provide our employees with the training and tools they need to do their jobs properly.

By way of elaborating on the structural imbalance point, I would like to address the subcommittee's attention to the chart at the end of my statement.

There is a chart, Mr. Chairman, on the very back page of the testimony. Do you find it?

Chairman PICKLE. Yes, sir. I see the chart.

Mr. GOLDBERG. The first column of that chart shows expenditure categories, like payroll costs. The second column shows the amount—those are 2-year cumulative figures. The amount that the Congress of the United States and the President, in signing the law, said we were going to spend on that activity.

The next column of numbers shows what we, in fact, spent for those activities, and the last column shows how much we overspent or underspent. As you will note, we spent close to $500 million more on payroll than the President's budget—the budget you all enacted and the President signed into law said we were supposed to spend. The net result of that $500 million—well, we ended up hiring only 454 more folks during that 2-year period. The reason for that difference is our payroll costs have been going up at the rate of 8.5 percent a year.

Rent of space. We spent $53 million more than your folks' budget said we ought to spend. How did we pay for those overruns, those escalating costs that weren't funded?

We spent $53 million less on communications. We spent $60 million less on training than your budget said we ought to spend. We spent $44 million less on travel. We spent $54 million less on discretionary space improvements. We spent $167 million less on ADP operations. Now, I want to emphasize that is not systems modernization. That is other ADP activities. And we spent $166 million less on printing, postage, supplies, services, expert witnesses and the like.

Now, I want to emphasize that these gaps, these shortfalls in training, travel, supplies, aren't shortfalls that reflect a difference between our wishful thinking and prudent expenditure levels. These shortfalls reflect the difference between what you and your colleagues and the administration believed we should be spending and the fact of what we have spent.

Mr. Chairman, as I will describe shortly, our proposed budget for 19——

Chairman PICKLE. Mr. Commissioner, do you have a total of all these actual amounts?

Mr. GOLDBERG. Well, these two are going to add up. We cut back on these other categories about $550 million. So we shortchanged training, travel, supplies, ADP maintenance, discretionary space improvements by a cumulative amount of about $550 million.

As I will describe shortly, our proposed budget for 1991 will permit us to lift our hiring and promotion freezes. It will begin restoring much needed programmatic efforts across the board, will reduce the persistent gaps, these gaps, between our budgets and our reality, and will begin to invest in the long-term health of our system. At the same time, however, we, the IRS, must improve the way we formulate and execute our own budgets. To this end, we have taken a number of steps and have a number of initiatives under way.

The actions we have taken have ranged from major organizational changes, such as creating the Chief Financial Officer and Controller positions for the first time in the Internal Revenue Service, to the restructuring of our appropriations accounts; from successful implementation of the budget execution module of our financial accounting system that now lets us know how much money we spend as we spend it, to the ongoing implementation of the financial accounting module; from strengthened internal budget review procedures to dismantling the wall that has separated accountability between the financial and operational sides of our activities; from ongoing development of cost control measures to aggressive pursuit of quality-driven productivity gains.

In the aggregate, I am confident that these efforts will assure greater accountability and far better use of our resources in the years ahead.

Mr. Chairman, I believe that our income tax system as we know it is at the crossroads. Our laws, regulations, and administrative procedures, coupled with our aging information systems, are placing an intolerable burden on the American public. Without question, the greatest challenge of the coming decade is to make the system more workable for the tens of millions of taxpayers who are willing to pay what they owe but cannot abide the complexity, uncertainty, and administrative hassles they face in complying with the law and in dealing with the IRS.

Now, at the same time, we face an annual tax gap of $80 to $100 billion. We are carrying more than $87 billion of accounts receivable on our books. When measured against the more than $1 trillion we do collect each year, it may not sound like much, but it is—particularly when measured against our hundred billion dollar deficits. We simply must do a better job of closing the tax gap and collecting unpaid taxes.

Our proposed 1991 budget properly and effectively addresses these twin concerns. I know you have all heard the line before. Commissioners come before your subcommittee, grit their teeth, smile and tell you all is well. I had the honor of serving as IRS Chief Counsel, and I have been coached and counseled many times on the rules of the game.

I assure you that we have worked closely and well with our colleagues at Treasury and OMB in putting our 1991 budget together. I assure you that all of us appreciate the vital importance of tax administration, its many accomplishments and shortcomings, its difficulties of the past several years, and the challenges that lie ahead. The proposed budget is not a panacea. The proposed budget "bets on the come." It is a tight budget predicated on our ability to achieve substantial cost savings and productivity gains that may or

may not materialize. Nonetheless, it provides reasonably adequate funding for 1991; of equal importance, it reflects a long-term commitment to restoring the health of our tax system.

Highlights of the request include: The budget funds an 80 percent level of taxpayer service to the public and strengthens our efforts to improve the accuracy of responses to taxpayers' questions. The 1991 budget will continue to support tax processing levels required to ensure that tax returns are processed accurately and refunds are issued timely. It will also permit us to pursue numerous efforts we have under way to ease the burden on taxpayers throughout the country, efforts that include a modified short form 1040A for use by taxpayers with retirement income; assistance to non-English-speaking taxpayers; assistance to the physically disabled; aggressive implementation of the taxpayer bill of rights; electronic filing; telephonic availability of taxpayer ID numbers; improved correspondence and expanded one-stop service.

On the enforcement side, the budget will permit us to lift the hiring freeze in our enforcement functions. It also provides $191 million in new funding for compliance initiatives to expand Collection and Examination activities. I want to emphasize that these initiatives represent the growth that we can properly manage and absorb during 1991. No more, no less. The first year of this investment will bring in $537 million that would otherwise go uncollected. Over the long term, these initiatives will slow the growth in accounts receivable and will reverse the steady decline in audit coverage. Of equal importance, they are an integral part of the administration's strategy, a long-term strategy to enhance our enforcement efforts.

Mr. Chairman, as you are aware, Tax Systems Modernization has been and remains a major Service initiative. We have the full support of Treasury and OMB in this effort, which has been designated one of a limited number of Government-wide management objectives by the President. The administration's budget fully funds the fiscal 1991 increment for systems modernization.

I cannot overemphasize the critical importance of this undertaking. On the down side, we agree with the General Accounting Office that the day of reckoning is about at hand. We must modernize our systems by the mid-1990's or face capacity shortages that could seriously jeopardize our tax administration efforts across the board.

Of equal importance, however, is that our existing systems, designed in the late 1950's, simply preclude us from providing an overall acceptable level of service to the American public. Needless delays, costly and time-consuming correspondence, erroneous taxpayer contacts and the like are simply unacceptable, but all too often they are the inevitable byproduct of our old computer technology. The only hope we have of meeting legitimate taxpayer expectations in dealing with their Government is to modernize our systems.

In this regard, I would like to emphasize that we are making——

Chairman PICKLE. Mr. Commissioner, before you go on, just in passing, how does the OMB or the administration accept your position about this modernization and the expenditures we have got to make?

Mr. GOLDBERG. I am sorry, Mr. Chairman?

Chairman PICKLE. What is their position with respect to your flat observation that a catastrophe is at hand if we don't modernize our system? Are they agreeable to that? Are they willing to meet the costs?

Mr. GOLDBERG. Mr. Chairman, they fully support it. At the highest levels of the Office of Management and Budget and the Treasury Department, it is crystal clear this is one of the primary objectives of this administration and represents a primary commitment of this administration to good government. And they are 100 percent behind it, and they are 100 percent behind paying what it costs to get it done.

Chairman PICKLE. Well, they are 100 percent behind the principle of making an improvement, will they be 100 percent behind doing it and be making a request for funds necessary to carry it out?

Mr. GOLDBERG. Mr. Chairman, they have assured me, and I assure you, they are going to put their money where their mouth is. And that money will be there. It is our job to do it right, and they are going to hold us accountable. You should hold us accountable. But the money is going to be there. They are going to support putting the money there.

Chairman PICKLE. All right. Thank you, Mr. Commissioner.

Mr. GOLDBERG. With respect to systems modernization, it is a long-term effort. And as you note, it is going to be very expensive. But I think it is important to emphasize that we are making progress. We are putting points on the board today, and taxpayers today are benefiting from the effort and will benefit more in the months to come.

As I have indicated, electronic filing is coming into its own this year. That electronic filing is at the leading edge of our modernization effort, fits quite importantly within that overall effort. It will be an integral part of the system in the years ahead.

As I have indicated, our current technology-based experiments in Boston and Dallas are improving the quality of our responses to taxpayer questions and holds promise for the future.

Our On-Line Entity Project is being implement in all 10 service centers this spring. That effort is already generating improvements in our quality and productivity, while significantly reducing the number of taxpayer contacts we would otherwise be required to generate.

We will be pilot testing the first phase of our Automated Underreporter System later this year. When fully implemented, this system is designed to provide our tax assisters and examiners with immediate access to case information, permit resolution of cases by telephone, and greatly reduce the need for protracted correspondence in our underreporter program.

During 1990 and 1991, we will continue to test various one-stop service concepts that are already reducing the runaround and difficulties that taxpayers confront in their dealings with us.

We will begin to replace the shipment of tapes from one center to another with a modern telecommunications infrastructure.

Our Fresno Service Center is testing a project this year to control taxpayer correspondence in a more timely fashion to prevent

automatic generation and mailing of additional, often unnecessary, notices to taxpayers. Fewer notices mean fewer hassles for everyone.

Let me also acknowledge that as we go down the road to modernizing our systems, we must pay more attention to the procurement process. In this regard, we have recently initiated a number of steps to improve our performance in this critical area. Nonetheless, as was so aptly highlighted at the General Accounting Office symposium on systems development last October, the Federal procurement process is terribly complex. My personal view is that our existing rules and regulations in this area could delay our modernization efforts by several years and could add significantly to our costs.

With respect to our budget, Mr. Chairman, maintaining the integrity of IRS operations is a key element in our administration of the tax laws and is fundamental to our system of voluntary compliance. Our internal audit and investigative resources for 1991 contain a proposed increase of 10 percent to assure that programs and personnel adhere to the highest standards of performance and conduct.

With respect to the structural balance point, that chart I referred to before, our proposed 1991 budget begins to eliminate the structural imbalances I have described. For the first time in several years, we will significantly enhance the training and the tools we provide our employees to enable them to properly administer our tax system.

Mr. Chairman, I can assure you with a great deal of confidence that we intend to spend the funds provided for in our 1991 budget in the manner we have described. At the same time, however, I have several words of caution.

First, the 1991 budget does not make up for prior year shortfalls. I am afraid that the tax system will continue to pay the price of the 1989-90 hiring freeze, and the failure to provide adequate training and support for our employees for years to come.

Second, as I have indicated, our budget is predicated on productivity gains and cost savings that will be necessary to offset cost increases that have not been funded but are virtually certain to occur. While I am confident that we will achieve these productivity gains and cost savings, there are no guarantees. Moreover, unanticipated cost increases, or the failure—for whatever reason—to fully fund our 1991 budget request, would impede our recovery and further undermine the health of our tax system.

Mr. Chairman, the President's budget for 1991 includes management initiatives which require no new resources from Congress. These initiatives are designed to collect $2.5 billion in 1991 and represent a new approach to how we conduct business. In brief, we plan to redeploy existing staff to accelerate the closing of large dollar cases and overage shelter backlogs, and resolve critical excise tax and pension plan issues.

Without getting into these initiatives in detail, I want to emphasize several points. First, they will greatly improve the way we run our business. In several instances, they are essential to avoiding serious difficulties down the road. Second, we can track, monitor, and measure our performance in these areas. Of equal importance,

others in the administration and the Congress will also be able to assess the results of our efforts. Third, there are no guarantees. We believe we can accomplish these goals, but they do represent challenging objectives. Finally, we can and should be held accountable. We expect to be held accountable. In my opinion, that is what good government is all about.

In conclusion, let me repeat the need for close coordination between tax legislation and tax administration. Predictability and simplicity, these are admirable goals that the administration and this committee have set for future tax policy development. This subcommittee and the full committee can point to the success in this area with respect to recent penalty reform legislation that originated in your subcommittee. Mr. Chairman, I look forward to discussing this and other areas with you in the months ahead.

Finally, I want to thank you and your colleagues for your continued support of the IRS. I look forward to working with you. This concludes my testimony.

Thank you very much.

[The statement of Mr. Goldberg follows:]

STATEMENT OF FRED T. GOLDBERG, JR.
COMMISSIONER OF INTERNAL REVENUE
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
HOUSE WAYS AND MEANS COMMITTEE

MARCH 22, 1990

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear here today to discuss the 1990 filing season and IRS' Fiscal Year 1991 budget request. With me today are Michael Murphy, Senior Deputy Commissioner; Charles Brennan, Deputy Commissioner (Operations); John Johnson, Deputy Commissioner (Planning and Resources) and our Chief Financial Officer; Hank Philcox, Chief Information Officer; Robert LeBaube, Assistant Commissioner (Taxpayer Service); and Charles Peoples Assistant Commissioner (Returns Processing). Also with us today are other IRS executives who should be able to answer any questions you might have.

Mr. Chairman, this appearance before your Subcommittee is particularly satisfying because I have two relatively straightforward and encouraging messages to deliver. In each case, I believe that you and your colleagues deserve a fair share of the credit for the good news.

First, the filing season to date has gone exceptionally well. Our ongoing investments in quality and technology are paying off, much to the benefit of the taxpaying public.

Second, budgetary shortfalls in FY 1990 have resulted in lost revenue and reduced levels of service. However, we now see light at the end of the tunnel. The President's FY 1991 budget request is a good and necessary beginning. If enacted, it will mark the start of a much needed, long-term investment in the health of our tax system.

I. THE 1990 FILING SEASON

A. Returns Processing. As a preliminary matter, I should point out that April 15 has not yet come and gone. We are working hard to manage our old systems, and we may still hit a few more potholes. I only hope that what I am about to say won't jinx the next 3 or 4 weeks!

The plain fact is that we are in the midst of a highly successful filing season. To illustrate the point, I would like to call the Subcommittee's attention to two statistics:

-- Taxpayers are filing earlier this year. As of March 9, we had received 44.8 million income tax returns, a 3.5 percent increase over last year.
-- We are processing returns much more quickly this year. Again, as of March 9, we had processed almost 33 million returns, a 12.5 percent increase over last year.

In my opinion, these positive developments reflect a number of factors, including: continued improvements in the quality of our processing efforts, improved forms distribution, our close working relationship with tax professionals, electronic filing, and enhanced quality in our taxpayer service program. In addition, credit should go the 90,000 volunteers in our VITA and Tax Counseling for the Elderly programs who will assist almost 4 million taxpayers complete their returns this year, and to the Ad Council and the news media for their support of our File Early/Make Taxes Less Taxing Campaign. Mr. Chairman, this is the 20th anniversary of our volunteer program, and we owe special thanks to hundreds of thousands of individuals and businesses for their support over the years.

The quality of our processing efforts and the quality of returns we are receiving from taxpayers and tax professionals also show marked improvement over last year. There have been significant improvements in almost all of our measures of "things gone wrong" when compared to the same items at this time last year:

-- The number of unpostables are down almost 15 percent.
-- Entity cases are down almost 18 percent.
-- Rejects are down 31 percent.
-- Unidentified remittances are down over 27 percent.
-- Blocks out of balance are down 19 percent.
-- The overall error rate has declined from almost 16 percent to under 14 percent.

These words may not mean much -- but the concepts do. They all reflect the cost of poor quality. When quality goes up, these indicators go down: taxpayers and the Service are doing it right the first time. And doing it right the first time means fewer delays in refund checks, fewer erroneous or unnecessary taxpayer contacts, and fewer needless hassles with the IRS.

Without question these improvements are the direct result of our continuing emphasis on quality and our investment in systems modernization. And they are a tribute to hard work, dedication and skills of employees and managers throughout the IRS.

B. Taxpayer Service. There are two sides to the story in taxpayer service this year. On the one hand, our taxpayer service accuracy rate, as measured by the Integrated Test Call Survey System, has improved substantially over last year -- from 61.4 percent to 76.2 percent this year. On the other hand, there has been a decline in our level of service -- from 84 percent last year to 71 percent this year. The former reflects our continuing emphasis on quality and our investment in systems modernization; the latter reflects the impact of our 1990 budget situation and a higher than expected volume of calls from taxpayers.

Mr. Chairman, as we have said on many occasions, taxpayers are entitled to correct answers from the IRS every time they call. Perfection is the only acceptable goal for this Agency in everything we do. At the same time, however, I think all of us can take enormous pride in the significant improvement in our accuracy rates this year. It reflects our continued emphasis on training, our use of more effective research materials, the fine work of our diagnostic centers, our technology-based experiments in Boston and Dallas, and -- above all -- the dedication and skills of our taxpayer service employees and managers.

While our progress is noteworthy, we can -- and should -- do better next year. We have learned a great deal from the progress we have made, and are already developing strategies to improve our performance again during 1991. With respect to the factors we control, I am optimistic. At the same time, however, taxpayers and the IRS alike are victims of needless and burdensome complexity in the law. To give but two examples, when our assistors must ask as many as 42 probing questions to correctly answer a taxpayer's question on the definition of head of household, and as many as 13 probing questions to answer a question on whether someone is required to file a return, we're all in trouble! Until we achieve greater simplification, particularly as it affects low and middle income taxpayers, our accuracy rates will continue to suffer.

With respect to level of service, two points are worthy of note. First, as I will describe shortly, we made a conscious decision to reduce our level of service to 75 percent this year as part of our efforts to deal with the 1990 budget shortfall, stemming largely from the sequester and pay raise absorption. Second, as you know, our level of service depends upon actual demand relative to projected demand. Actual demand is running 7

percent ahead of our projections, causing our level of service to decline to approximately 71 percent. We will answer 2.4 million fewer calls this year, and taxpayers will endure more busy signals. Finally, our average time per call has remained constant -- confirming our view that we can enhance quality and maintain productivity at the same time. On the other hand, the number of individuals served at our walk-in taxpayer service offices will increase by approximately 7.2 percent this year.

Before turning to electronic filing, I would like to mention the taxpayer service projects we have under way in Boston and Dallas. As you know, Mr. Chairman, the Boston effort involves the use of computers and "expert systems" that guide our assistors to correct answers; the Dallas effort equips our assistors with computerized research materials. In each case, we believe these efforts are generating significant improvements in quality.

While many of us are extremely enthusiastic about their long-range promise, I want to emphasize that these efforts are just getting started. We have a great deal to learn. We must be particularly sensitive to the human side of the equation: as we pursue these technologies, we must provide proper training and work with the National Treasury Employees Union to assure enhanced job satisfaction and professional opportunities for all of our affected employees.

We have made no final decisions with respect to expanding these projects to additional call sites. At the present time, however, we anticipate the following for the 1991 filing season: Three of our 31 call sites will implement comprehensive pilot projects. These pilots will include both the Boston and Dallas efforts and will also automate a number of related taxpayer service functions. In addition, we will place the expert system in approximately 4 additional call sites. At the same time, of course, we will build on our experience this year to improve the quality in the remaining 24 locations. We believe this strikes a proper balance between the need to change and improve the way we do business with our need to learn more about the human equation of new information systems we are introducing. We must also contend with budgetary constraints, the procurement nightmare and practical limits relating to site configuration, electric power constraints, and the like.

C. Electronic Filing. Electronic filing became available on a nation-wide basis for the first time this year. The program has been an overwhelming success; the numbers speak for themselves:

- -- We projected 1.8 million returns for the entire filing season -- we have more than 3.5 million to date, and the number grows daily!
- -- More than 92 percent of the refunds for electronically filed returns have been issued within three weeks after receipt by the IRS.
- -- More than 98 percent of the refunds for electronically filed returns have been issued within four weeks after receipt by the IRS.
- -- More than 82 percent of the taxpayers who have filed electronically have opted for direct deposit of the refunds -- effectively shaving a week off the refund timetable for these taxpayers.
- -- Only approximately 40,000 refunds have taken more than four weeks to issue, and all of these refunds have been issued in less than ten weeks.

Faster refunds are certainly an important part of the story. But many of us believe that quality improvement is an equally important aspect of electronic filing. The error rate associated with paper returns (e.g., math errors, as well as our own

transcription errors) is running at approximately 14.6 percent this year. While this represents a significant improvement over prior years, the error rate for electronically filed returns is less than 5 percent! Moreover, errors associated with electronically filed returns are generally identified early in the process and are almost always resolved within a matter of days after filing. Unfortunately, our current systems are such that errors associated with paper returns may not be resolved for months. In the meantime, costs and frustration levels continue to rise for taxpayers and the IRS alike.

While much of the public focus has been rightly centered on the time it takes to process a return and issue a refund, electronic filing demonstrates how our modernization efforts will improve our work in other ways. Another feature of electronic filing is the ability to "call up" a copy of a return -- whether requested by the taxpayer or an IRS employee -- in far less time than it currently takes to requisition and obtain a paper return which has been stored in a Federal Records Center. The ease and quickness of printing a hardcopy of an electronically filed return will significantly improve our responsiveness to taxpayers as well as IRS offices which need that return.

While electronic filing is exceeding our expectations this year, we have encountered a number of problems. For example:

-- A break-down of certain procedures in a tape shipment from Cincinnati to our Computing Center in Martinsburg, West Virginia resulted in a two week delay in issuing refunds from returns contained on those tapes.
-- A tape that was shipped from Ogden to Martinsburg was damaged, resulting in a one week delay in issuing refunds for returns contained on that tape.
-- Certain taxpayers with changed filing status (e.g., a name change, married or divorced, etc.) could experience refund delays of one or two weeks.
-- Treasury has encountered a number of unanticipated processing errors that have delayed refunds by several weeks for approximately 2,300 taxpayers.

As a practical matter, these difficulties are quite minor in the context of the overall program, and none have caused refund delays of more than a few weeks. Of equal importance, they are not problems occasioned by electronic filing -- most were caused by our older processing systems. Indeed, these very same occurrences caused similar delays for taxpayers who had filed paper returns. Finally, I would like to note that progress in modernizing our systems over the next several years will preclude many of the problems from recurring.

Despite the success of electronic filing this year, I want to emphasize that the program is still in its infancy and significant improvements will be required down the road. For example:

-- We need to expand electronic filing to include balance due as well as refund returns.
-- We need to devote constant attention to security and quality control issues.

-- We need to explore avenues for helping small preparers offer electronic filing services to their clients.
-- We need to consider ways to let individuals who prepare their own returns enjoy the benefits of electronic filing.
-- We need to determine whether we can avoid the problems inherent in shipping tapes through electronic hook-ups between our Service Centers and our Martinsburg

Computing Center.

-- We hope and expect that "market forces" will dramatically cut taxpayers' costs for electronic filing in the years ahead.

Mr. Chairman, we are currently refining our electronic filing strategy for the 1991 filing season and the years ahead. I believe we are making a great deal of progress, and look forward to sharing our plans with you, your colleagues and the taxpaying public in the months ahead.

D. Tax Systems Modernization. I do not want to leave the filing season topic without mentioning Tax Systems Modernization. I believe that the future of our tax system hinges on this endeavor. We must succeed -- or face very serious computer capacity shortages by the mid-1990's. We must succeed if we are to provide the level of quality in tax administration that the American public has every right to expect and demand from our government, the same level of quality provided by most private sector financial firms.

Systems modernization is a long-term effort that will not be completed for many years and requires a significant capital investment. At the same time, however, the plain fact is that we are already seeing demonstrable and significant benefits. I have already mentioned electronic filing and our taxpayer service projects in Boston and Dallas. There are others; I would like to mention one. Phase I of the On-Line Entity project ("OLE"), a system to improve certain data we enter into our processing systems, has been up and running in our Memphis Service Center since last fall; it is now in place in five additional service centers and will be implemented in our remaining four service centers within this spring. We know that OLE has already contributed to the improved quality of our processing operations this year. When subsequent phases are fully implemented in 1991 and 1992, we are absolutely convinced that it will generate significant quality improvements in our service center operations.

E. Tax Law Changes. As I have indicated, the success we are enjoying this year has many causes, ranging from our emphasis on quality and systems modernization to the dedication and skills of our employees and the vital role played by 90,000 volunteers.

But there is another, all-important reason why the filing season has gone so well. Other than repeal of the catastrophic health care surtax, there were no last minute law changes with current year effective dates. My personal view is that this may be the major reason for our success.

The tax law can, should and will change with the times. For the foreseeable future, it is likely that these changes will occur each year. For the sake of tax administration at the Federal, state and local level . . . for the sake of tax professionals and commercial preparers . . . and for the sake of the taxpaying public -- do it early, or do it with future year effective dates.

II. IRS' BUDGET

A. Background. The other focus of this hearing is on our current budget posture and our proposed budget for 1991. The best way to begin is by reviewing what has taken place during the past ten years and to describe the challenges facing our tax system during the decade of the 1990's.

Between 1981 and 1990, the number of tax returns filed will have increased from 160 million to 190 million (a growth of 20 percent); the number of information documents filed will have increased from 600 million to 1.2 billion (a growth of 100 percent); and we will have implemented annual changes in the tax

law involving 2,381 Code sections -- changes that have required substantial modifications to all of our existing forms and instructions, the creation of 81 new forms, significant annual computer programming changes, and material revamping of training programs throughout the Service.

During that same period, there have been cumulative pay increases of approximately 40 percent and our health and retirement costs have increased approximately 200 percent and 90 percent respectively. At the same time, we have incurred increased costs to help recruit qualified personnel in highly competitive labor markets and inflationary increases in other employee support costs. In addition, the cost of maintaining our outmoded and old computer systems has started to skyrocket and we are now investing in the long term modernization of our computer systems. Last but not least, other Federal agencies (notably, the General Services Administration and the National Archives and Records Administration) have passed along significant inflationary cost increases.

Without getting into the question of whether IRS budgets have kept pace with the foregoing, it is clear that our resources have grown substantially. Our budget increased from $2.5 billion and 84,700 staff years in 1981 to $5.5 billion and a projected 115,000 staff years for 1990 (a 120 percent growth in nominal dollar terms, and a growth in staff years of approximately 35 percent).

Much of the increase in our direct and indirect payroll costs was anticipated and appropriate; unfortunately, some of that increase was handled inefficiently or was simply unanticipated. We have accomplished a great deal in many programmatic areas; unfortunately, we have witnessed declines in productivity in our traditional enforcement functions such as Collection and Examination. Some of our difficulties have resulted from the budget process itself. In other respects, the problems are clearly of our own making. The absence of <u>steady</u> growth rates has only made matters worse; our budget increases fluctuated wildly during the '80's, from a high of 14 percent in 1987 to a low for the current year of less than 3 percent.

In any case, we have experienced greater than budgeted direct and indirect payroll costs, slower than anticipated attrition, and greater than budgeted space costs and equipment maintenance costs during the past five years. And for the past fifteen months we have been paying the piper, especially in the context of the FY 1990 unbudgeted pay raise and sequestration:

- -- A partial or complete hiring freeze in most of our programmatic activities that will not be lifted for months to come.
- -- A partial freeze on promotions throughout the Service since last November.
- -- Programmatic cutbacks that will remain in place for months to come: cutbacks that have cost, and will continue to cost, millions of dollars in revenue; cutbacks that have reduced our level of service to taxpayers this filing season.
- -- Structural imbalance in our budget; a continuing failure to invest in our future -- providing employees with mandatory training, but failing to provide our employees with supplemental or special training and other tools they need to do their jobs properly.

By way of elaborating on the "structural imbalance" point, I would like to address the Subcommittee's attention to the chart at the end of my statement.

Mr. Chairman, I want to emphasize that these gaps do not reflect the difference between IRS wishful thinking and prudent

expenditure levels. They reflect the differences between what you and your colleagues (together with the Administration) have believed we should be spending and what we have in fact spent.

B. Management Initiatives in Budget Formulation and Execution. Mr. Chairman, as I will describe shortly, our proposed budget for 1991 will permit us to lift our hiring and promotion freezes, will begin restoring much needed programmatic efforts across the board, will reduce the persistent gaps between our budgets and our reality, and will begin to invest in the long-term health of our system. At the same time, however, we must improve the way we formulate and execute our budgets. To this end, we have taken a number of steps and have a number of initiatives under way. These actions have ranged ....

- -- from major organizational changes (such as establishing the Chief Financial Officer and Controller positions) to the restructuring of our appropriation accounts;
- -- from successful implementation of the budget execution module of our financial accounting system to the ongoing implementation of the financial accounting module;
- -- from strengthened internal budget review procedures to dismantling the wall that has separated accountability for the financial and operational sides of our activities;
- -- from ongoing development of cost control measures to aggressive pursuit of quality-driven productivity gains.

In the aggregate, I am confident that these efforts will assure greater accountability and far better use of our resources in the years ahead.

C. Our FY 1991 Budget Request. Mr. Chairman, I believe that our income tax system as we know it is at the crossroads. Our laws, regulations and administrative procedures -- coupled with our aging information systems -- are placing an intolerable burden on the American public. Without question, the greatest challenge of the coming decade is to make the system more workable for the tens of millions of taxpayers who are willing to pay what they owe, but cannot abide the complexity, uncertainty and administrative hassles they face in complying with the law and in dealing with the IRS.

At the same time, we face an annual tax gap of $80 to $100 billion and carry more than $87 billion of accounts receivable on our books. When measured against the more than one trillion dollars we do collect each year, this may not sound like much. But it is -- particularly when measured against our hundred billion dollar deficits. We simply must do a better job of closing the tax gap, and collecting unpaid taxes.

Our proposed 1991 budget properly and effectively addresses these twin concerns. Now I know that you've heard the line before -- Commissioners come before your Subcommittee, grit their teeth, and tell you all is well. I had the honor of serving as IRS Chief Counsel several years ago, and I have been coached and counseled many times on the "rules of the game."

Mr. Chairman, I assure you that we have worked closely and well with our colleagues at Treasury and OMB in putting our 1991 budget together. I assure you that all of us appreciate the vital importance of tax administration, its many accomplishments and shortcomings, its difficulties of the past several years, and the challenges that lie ahead. The proposed budget is not a panacea; it also "bets on the come" -- it is a tight budget predicated on our ability to achieve substantial cost savings and productivity gains that may or may not materialize. Nonetheless, it provides reasonably adequate funding for 1991 -- of equal

importance, it reflects a long-term commitment to restoring the health of our tax system. In brief, our request for FY 1991 totals $6.1 billion and nearly 120,000 staff years, an increase of some $635 million and nearly 4,000 staff years over last year. Highlights of our request include:

1. Tax Processing and Taxpayer Service. The budget funds an 80 percent level of taxpayer service to the public (up from 75 percent budgeted for 1990) and strengthens our efforts to improve the accuracy of responses to taxpayers' questions. The 1991 budget will continue support of tax processing levels required to ensure that tax returns are processed accurately and refunds are issued timely. It will also permit us to pursue numerous efforts we have under way to ease the burden on taxpayers throughout the country -- efforts that include a modified short Form 1040-A for use by taxpayers with retirement income; assistance to non-English speaking taxpayers; assistance to the physically disabled; aggressive implementation of the Taxpayer Bill of Rights; electronic filing; Tele-TIN; improved correspondence and expanded one-stop service.

2. Enforcement Activities. The budget also provides $191 million in new funding for compliance initiatives to expand Collection and Examination activities. I want to emphasize that these initiatives represent the growth we can prudently manage and absorb during 1991. No more, no less. The first year of this investment will bring in $537 million that would otherwise go uncollected. The initiatives will help slow the growth in accounts receivable and reverse the steady decline in audit coverage. Of equal importance, they are an integral part of our long-term strategy to enhance our enforcement efforts.

3. Systems Modernization. As you are aware, Tax Systems Modernization has been and remains a major Service initiative. We have the full support of Treasury and OMB in this effort, which has been designated one of a limited number of government-wide management objectives by the President. The Administration's budget fully funds the FY 1991 increment of systems modernization.

Mr. Chairman, I cannot over-emphasize the critical importance of this undertaking. On the downside, we agree with GAO that the day of reckoning is about at hand. We must modernize our systems by the mid-1990s or face capacity shortages that could seriously jeopardize our tax administration efforts across the board.

Of equal importance, however, is that our existing systems, designed in the late 1950's, preclude us from providing an acceptable level of service to the American public. Needless delays, costly and time consuming correspondence, erroneous taxpayer contacts, and the like are simply unacceptable -- but the inevitable by-product of our old computer technology. The only hope we have of meeting legitimate taxpayer expectations in dealing with their government is to modernize our systems.

In this regard, I would like to emphasize that we are making progress on a number of fronts. While modernization will be a costly, difficult and long-term effort, we have started "putting points on the board." Taxpayers are already benefitting and will benefit even more during the next 18 months. For example:

-- As I've already indicated, electronic filing is coming into its own this year. This program is at the leading edge of our modernization effort and will be an integral part of our modernized system in the years ahead.
-- As I've also indicated, our current technology-based experiments in Boston and Dallas are improving the quality of our responses to taxpayer questions this

filing season, and hold great promise for the future.

-- Likewise, our On-Line Entity Project is being implemented in all ten Service Centers this spring. It is already generating improvements in our quality and productivity, while reducing the number of taxpayer contacts that we would otherwise generate.

-- We will be pilot testing the first phase of our Automated Underreporter System later this year. When fully implemented, it is designed to provide our tax assistors and examiners with immediate access to case information, permit resolution of cases by telephone, and greatly reduce the need for protracted correspondence in our underreporter programs.

-- During 1990 and 1991 we will continue to test various one-stop service concepts that are already reducing the run-around and difficulties that taxpayers confront in their dealings with us.

-- We will begin to replace the shipment of tapes from one center to another with modern telecommunications.

-- Our Fresno Service Center will test a project designed to record taxpayer correspondence in a more timely fashion to prevent automatic generation and mailing of additional, often unnecessary notices to taxpayers. Fewer notices mean fewer hassles for everyone.

Let me also acknowledge that as we go down the road to modernizing our systems, we must pay more attention to the procurement process. In this regard, we have recently initiated a number of steps to improve our performance in this critical area. Nonetheless, as was so aptly highlighted at the GAO symposium on systems development last October, the Federal procurement process is terribly complex. My personal view is that our existing rules and regulations in this area could delay our modernization efforts by several years and could add significantly to our costs.

4. Integrity. Maintaining the integrity of IRS operations is a key element in our administration of the tax laws and is fundamental to our system of voluntary compliance. Our internal audit and investigative resources are up almost 10 percent in 1991 in order to assure that programs and personnel adhere to the highest standards of performance and conduct.

5. Structural Balance. Our proposed 1991 budget begins to eliminate the structural imbalances I previously described. For the first time in several years, we will start to provide our employees with more of the training and tools they need to properly administer our tax system.

On the one hand, Mr. Chairman, I can assure you with a great deal of confidence that we will indeed spend the funds provided for in our 1991 budget in the manner indicated. At the same time, however, I have several words of caution.

First, the 1991 budget does not make up for prior year shortfalls. I am afraid that the tax system will continue to pay the price of the 1989 - 1990 hiring freeze and failure to provide adequate training and support for our employees for years to come.

Second, as I have indicated our budget is predicated on productivity gains and cost savings that will be necessary to off-set cost increases that have not been funded but are virtually certain to occur. While I am confident that we will achieve these productivity gains and cost savings, there are no guarantees. Moreover, unanticipated cost increases -- or the failure (for whatever reason) to fully fund our 1991 budget request -- would impede our recovery and further undermine the health of our tax system.

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6. Management Initiatives. The budget contains management initiatives which require no new resources from the Congress. These initiatives, designed to collect $2.5 billion in 1991, represent a new approach to how we conduct business. In brief, we plan to redeploy existing staff to accelerate the closing of large dollar cases and overage shelter backlogs, and resolve critical excise tax and pension plan issues.

Without getting into these initiatives in any detail, I want to emphasize several points. First, they will greatly improve the way we run our business; in several instances, they are essential to avoiding serous difficulties down the road. Second, we can track, monitor and measure our performance in these areas. Of equal importance, others in the Administration and the Congress will also be able to assess the results of our efforts. Third, there are no guarantees. We believe we can accomplish these goals, but they do represent challenging objectives. Finally, we can and should be held accountable; we expect to be held accountable. In my opinion, Mr. Chairman, that's what good government is all about.

III. CONCLUSION

In conclusion, let me repeat the need for close coordination between tax legislation and tax administration. Predictability and simplicity -- these are admirable goals that the Administration and this Committee have set for future tax policy development. The Subcommittee and the full Committee can already point to success in this area with the recent penalty reform legislation that originated in your Subcommittee, Mr. Chairman. I look forward to discussing other areas that are ripe for simplification.

Finally, I want to thank you and your colleagues for your continued support of the IRS. I look forward to working with you in the months and years ahead. This concludes my testimony. We would be happy to answer any questions you or other members of the Subcommittee may have.

INTERNAL REVENUE SERVICE: Structural Imbalance, FY 1989 - FY 1990
(DOLLAR AMOUNTS IN MILLIONS)

Expenditure Category	Amount Reflected in Budget Approved by Congress and Signed into Law	Actual Expenditure	Actual Exceeds (Less Than) Budget by:
Direct and Indirect Payroll Costs	$7,339	$7,830	$491
FTE - Positions	229,396	229,850	454
Rent of Space Expense	$708	$761	$53
Communications	$466	$413	($53)
Training	$181	$121	($60)
Travel	$220	$176	($44)
Discretionary Space Improvements	$114	$60	($54)
ADP Operations	$670	$503	($167)
Other (Printing, Postage, Supplies, Services, Expert Witnesses, etc.)	$997	$831	($166)

Chairman PICKLE. Well, we thank you, Commissioner. You have given us a very lengthy report of your analysis and your plans. I would say individually that I think this is a very good overall statement for us to have and to study. I appreciate your forthright position on many of these issues. I hope that you have the full cooperation now of OMB and the administration and this committee in carrying out what I think are your high goals.

Of course, we have a lot of questions, and I want to recognize the members as quickly as we can.

Let me ask you first, though, you made reference a minute ago to the fact that our computer system is out of date. You said that the time is at hand for possible catastrophe and we have got to do something about it, and the administration is going to do it. Now, you have said that even though you are going to request the money, you still say that we face catastrophe, you said, unless our existing rules and regulations in this area are not changed.

Why do we face a possible catastrophe in that area? What are you recommending? I am talking about the area of procurement.

Mr. GOLDBERG. Mr. Chairman, the procurement rules in the Federal Government as they apply to large systems acquisitions—and this was all laid out very clearly in the General Accounting Office's symposium—are extremely complex. You go through step after step after step, and there are appeals procedures after appeals procedures. And all those rules are designed to——

Chairman PICKLE. You mean the fact that you have to put out bids, offers for bids and so forth?

Mr. GOLDBERG. They are designed to protect competition, and that is very important. I think that is essential in the Federal Government. But the fact is the nature of those rules—if you look at them in the aggregate, puts us in a posture where it takes us 30 months to do an acquisition that in the private sector would take 6 months. And that is just a fact.

Chairman PICKLE. Well, what are you recommending since you point out the problem now?

Mr. GOLDBERG. Mr. Chairman, we are working closely with our colleagues at the Treasury Department, and we are working closely with our colleagues at the Office of Management and Budget to see whether there is a better way to do the job that assures integrity, assures fair and open competition, and I hope that we will be developing proposals in this regard in the near term for submission to the Congress.

Chairman PICKLE. What do you mean in the near term? Will you give to us your recommendation? Are you going to ask for the privilege of bypassing the normal bid process?

Mr. GOLDBERG. Mr. Chairman, we are not far enough down that road to give you any details. It is something we have to coordinate very closely with the administration.

Chairman PICKLE. But I recognize the problem. I can see what you mean. Now, I am looking for some way that you can carry it out. If a change is to be done, we need to be advised up here on the Hill.

I don't know that there is a way to do it. We would like to work with you if you have a suggestion.

Mr. GOLDBERG. Mr. Chairman, I appreciate your interest. This is an administration——

Chairman PICKLE. Also, just in passing, you made the statement with respect to your structural imbalance, and you pointed out your little chart here when I asked you about the overall costs.

Mr. GOLDBERG. Yes, sir.

Chairman PICKLE. It looks to me like if you took the first three categories, direct and indirect payroll costs, on positions and on space, that there is a shortfall there of $998 million. Then you make cuts in the areas that follow, in about four different areas: communication, training, travel, and discretionary space, and on down to ADP operations. That makes about $636 million in cuts, submitted cuts. That leaves an imbalance of about $362 million, and I am just asking where you are cutting to make up that difference.

Mr. GOLDBERG. Mr. Chairman, that is a little bit misleading. The second line is positions. It is number of people not dollars. So just cross off that 454.

Chairman PICKLE. Say that again. I didn't hear you.

Mr. GOLDBERG. That 454 is the number of employees. It is not dollars.

Chairman PICKLE. Oh, I see. All right. Well, that will make a difference on my question, then.

Mr. GOLDBERG. And remember, these are 2-year numbers.

Chairman PICKLE. All right. Now, Mr. Commissioner, last year through March 3, it wasn't the complete filing season but at that date, 5.4 million taxpayers received a busy signal when calling the Internal Revenue Service for assistance. This year, 16.4 million taxpayers received a busy signal. Now, this is twice the number of calls that have been answered; that is, about 8 million. What has happened?

Mr. GOLDBERG. Mr. Chairman, I will speak generally; then I would like to ask Bob LeBaube to give you more details on that.

For the last 18 months, this agency has been in what I would describe as a workout posture. We have had hiring freezes. We have made cutbacks in programmatic efforts across the board. And taxpayer service is one of many areas where we have had to cut back what we are doing to make our budget balance. Now, Bob, you——

Chairman PICKLE. Yes; and, Mr. Commissioner, I noticed that in your testimony that you pointed this out almost as if it was a kind of achievement on your part. And I say to myself, hey, you are going backward. We have been emphasizing taxpayer services, and yet you have actually had to cut that back. Now, I am glad you are getting a better accuracy rate, but you are getting a higher likelihood of busy rate.

Mr. GOLDBERG. Mr. Chairman, I view the achievement that this agency has managed itself through very difficult budget times in a balanced way. It makes me sick that the level of service is at that level, but it also——

Chairman PICKLE. Say that again?

Mr. GOLDBERG. It bothers the hell out of me that taxpayer service has declined that much. But it also bothers me that we have had hiring freezes in our examination function, in our collection

function. We have not spent $60 million on training. All that stuff bothers me, Mr. Chairman. I am not proud of any of it.

What I am proud of is that this agency has come to terms with a difficult situation in a balanced way.

Chairman PICKLE. Well, I think we will agree with you that progress is being made. But it should frighten us that we are losing ground in probably the most important aspect of all, taxpayer service.

Now, you wanted one of your staff people to make a comment.

Mr. LEBAUBE. Yes. Mr. Chairman, there are two things that are involved with the increased number of busy signals that people are receiving. One of them is, of course, the decision that we made to lower the level of service because of the budgetary problems that we had.

The second, though, has to do with the number of taxpayers who are attempting to call us. We have an increase in demand of about 7 percent. If that did not exist—we had projected the same approximate level of demand as last year—we would be running about a 78 percent level of service. But that isn't the case. About 7 percent more people are trying to reach us. That causes the number of busy signals to go up also.

Chairman PICKLE. You have obviously put better qualified people on the phone. Even though we can't get to them, they are more experienced and they can answer the question better. At the same time, I am advised that the accuracy rate in the Boston and Dallas demonstration project still didn't measure up to the national level of accuracy. Is that correct?

Mr. LEBAUBE. As far as site numbers are concerned, it is still too early to have a precise measurement. But that is not the way we see it going currently. Both the Dallas and the Boston sites are, by our numbers, up with and above the national average.

Chairman PICKLE. Well, my staff has advised me actually that the accuracy rate of the Boston and the Dallas operation has not stayed even with the national average. Would you submit us some data as to the facts on that?

Mr. LEBAUBE. We certainly will, sir.

[The following was subsequently received:]

BOSTON AND DALLAS ACCURACY RATES

The Boston and Dallas call sites had the following accuracy rates for telephone taxpayer service for the filing period through March 31, 1990: Boston, 78.8 percent; Dallas, 83.4 percent; while the national average was 76.8 percent.

Chairman PICKLE. All right. Thank you.

I see Mr. McGrath is not here. Mr. Anthony, do you have any questions?

Mr. ANTHONY. Thank you, Mr. Chairman.

Commissioner Goldberg, I would like to congratulate you on a very comprehensive presentation before the committee, but also I would like to commend you for having the courage to speak publicly rather than privately about some of the problems that exist at the agency. And I hope the committee can work with you to fulfill what I personally detect is a very keen desire on your part to be an exemplary Commissioner and to go down on the record maybe as

one that turned it around and really got in going into the 21st century. So I appreciate the vigor with which you are attacking this complicated job.

However, I haven't been able to get an answer to my question which I asked over a month ago about what Federal agencies refused or neglected to file with the Service. I remember you were going to run a computer list that was only going to take a few days to prepare, and it was going to take you a week or two to run that program? Why haven't you been able to run those reels through to get that list of taxpayers who owe $100 million or more?

Mr. BRENNAN. Let me first apologize. I thought we had gotten you an answer, but I find in my briefing book it is in draft. We should have an answer for the committee within the next couple days.

In terms of the 14 cases that are over $100 million, I can give you some more information on those specifically, and I will touch on the Federal agencies at the end.

Of the 14 cases over $100 million, I would characterize 6 of those as in various types of litigation, including bankruptcy. So while we have an assessment on the books, the taxpayers are exercising their right to litigate the amount, and the ones that are in bankruptcy, obviously, are also. Six others are errors, either on our part or the taxpayer's part. One has to do with money laundering, and the other one is just an "other" situation.

In terms of the Federal agencies, there was a little confusion, I would say, on my part. Last time we talked about one or two. There is actually only one Federal agency in this list of 14, and that Federal agency did not owe us any money, nor does that Federal agency owe us any money. That was one that I characterized as an error. What happened with that particular agency is they used a different employee identification number when they were mailing in their tax payments than they should have with their account. So they did timely mail their tax payments to us. Unfortunately, they used the wrong EI number, employer identification number, and so we put it in the wrong account and sent them a bill. Once we got the two together, we were able to offset that.

The other entity that looks like a Federal agency is actually a State agency. And the same thing there. What they used is another State agency's—with a similar name—identification number. So, again, the money comes in timely, but when you use a wrong number, we put it in a wrong account.

That deals with the over $100 million. We have surveyed and looked at our records in terms of do we have other Federal agencies below that level. There are a number of Federal agencies below that level—and we will cover this in our reply to you—that owe us money, are on the books, but in talking with our revenue officers who handle those cases, most if not all of them are similar situations to what I have just described; where the money just goes astray, either due to their errors or our errors.

Mr. ANTHONY. Unfortunately, you have got me in the middle on your answer between my briefing papers from our staff and your answer that is generated off of working papers that I have. So I guess what I would ask you to do is work with our staff to make sure that the 14 cases that you are referring to today are the same

14 cases that they looked at in September of 1989. And if they are, make sure that we have on the record the correct response; and if they are not, any addendum information that would straighten this particular situation out.

Mr. BRENNAN. We will certainly do that, sir.

[The following was subsequently received:]

We have verified that these are the same 14 cases which were analyzed in September of 1989. A copy of our letter which we provided to the Subcommittee on March 29, 1990 covering these 14 cases is attached.

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

DEPUTY COMMISSIONER

MAR

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
House Committee on Ways and Means
1105 Longworth Building
Washington, DC 20515

Dear Mr. Chairman:

In partial response to your February 2 request, this letter provides a publicly disclosable review of cases involving accounts receivable greater than $100 million as of September 30, 1989, with subsequent actions noted where applicable. The descriptions in parentheses indicate the causes or statuses of the cases. Other requested listings of cases at the $10 million and $50 million levels will be provided shortly under separate cover.

CASES OVER $100 MILLION

1. The taxpayer, a corporation, is currently in appeals for examination assessments. Assessments amounted to $253 million. (Litigation)

2. The taxpayer, a corporation, has had assessments of $179 million during the course of an ongoing examination. The ultimate liability will not be known until the conclusion of the examination. (IRS & Taxpayer Error)

3. The taxpayer, an individual, has a balance due of $123 million, and has been in litigation with IRS for several years. A substantial portion of this amount is not involved in litigation but is in currently not collectible (CNC) status due to financial hardship. No money has been collected from any source in over four years. (Litigation)

4. The taxpayer, an individual, filed returns showing large amounts of interest income from banks. The amount assessed is $122 million. No proceeds were received from levies of the banks' branches or subsidiaries, and it is uncertain whether the bank accounts ever existed. No current income or assets have been found and the taxpayer's address is unknown. (Other)

5. The taxpayer, a non-Federal government entity, was required to file Form 941, Quarterly Return of Withheld Income Tax. The aggregate balance due was $115 million. Problems occurred when another non-Federal governmental entity with a similar name filed returns using the wrong Employee Identification Number (EIN). Abatements have been made and the entity now shows a zero balance. (Taxpayer Error)

6. The taxpayer, a Federal agency, was using two EINs. The balance ($252 million) was caused by the credits posting to one EIN and the return posting to the other EIN. IRS has merged the accounts and the credits will satisfy the balance due. (Taxpayer Error)

7. The taxpayer, a bankrupt corporation, has a balance due of $290 million caused by an audit of several tax years. The taxpayer has been in litigation with IRS for several years. The corporation was merged into a new company, which reached a settlement agreement with IRS and is making payments until the settlement is satisfied. (Litigation)

8. The taxpayer, a corporation, was assessed $223 million after the court decision was finalized on its bankruptcy petition. The outcome of the case depends on the results of our collection investigation; however, it appears that little or no money will be realized. (Litigation)

9. The taxpayer, a corporation, had an account which reflected a balance due of $125 million. An amended return was filed and the account has been fully abated. (Taxpayer Error)

10. This individual taxpayer was involved in a money laundering scheme. Assessments resulted from the arrest of the taxpayer carrying a large sum of money, for which the amount owed was $151 million. The taxpayer fled the country. The liability is in currently not collectible status because no assets have been found. (Money Laundering)

11. A corporation timely filed its Form 940, Employer's Annual Federal Unemployment Tax Return. Due to a processing error, an erroneous assessment of $114 million was made. The erroneous assessment was abated and the account now reflects a zero balance. (IRS Error)

12. A musical group, whose members were in a partnership, was erroneously assessed a $150 million penalty. The penalty has been abated in full. (IRS Error)

13. & 14. The taxpayers, investors and speculators, are currently in bankruptcy. The combined amount owed is $965 million. (Litigation)

As we testified, much of the increase in the accounts receivable inventory during the 1980s was caused by economic growth, law and accounting changes, and increased IRS enforcement activities. As you know, the accounts receivable

total generally reflects liabilities arising over a six-year period. Between 1984 and 1989, IRS collected over five trillion dollars in revenue and the current inventory is less than two percent of that amount. During the mid-1980s, IRS projected a growth pattern in the accounts receivable inventory through the end of the decade. Due in part to various management initiatives, that inventory is now $10 to $15 billion less than projected.

The President's FY 1991 budget represents the first step in a much needed investment in our collection resources, restores training to appropriate levels, and fully funds the FY 1991 increment of our long-term systems modernization effort. I am confident that these and other steps will help slow the growth in accounts receivable and will help us collect revenue that is due in a more timely fashion.

Sincerely,

Charles H. Brennan
Deputy Commissioner
(Operations)

Mr. ANTHONY. In terms of the $2.5 billion through new management initiatives that is in the President's revenue package, am I to take it from your answer to my previous question that none of the 14 cases you just described, where a taxpayer owes $100 million or more, will be included in the revenue base of that $2.5 billion?

Mr. BRENNAN. That is correct, sir. The $2.5 billion has nothing to do with collection at all.

Mr. ANTHONY. Could you give us some indication of where the bulk of the cases are? Are they tax shelter cases?

Mr. GOLDBERG. The $2.5 billion, Mr. Anthony?

Mr. ANTHONY. Yes, sir.

Mr. GOLDBERG. Yes. There are three or four primary areas. One area is tax shelters. We are carrying a 400,000 unit inventory of pre-1987 tax shelter cases, real old cases, and those folks are tied up in that stuff. We had a work plan that said we would work approximately 100,000 of those cases during 1991. We have gone back. We have looked at that inventory. We are looking at different ways of working that inventory. And we are now doing some redeployment of resources, some reconfiguring of the way we compute settlements and work with shelters. And we believe that during 1991 we will close approximately 165,000 instead of the targeted 100,000. So that incremental 65,000 cases gives rise to the additional revenue associated with the shelter inventory.

A second area: There are approximately 250,000 small defined benefit pension plans in the country. Our original plans had called for us to audit approximately 200 of those 250,000. We now plan to deal with approximately 10,000 of those plans, or 5 percent of the universe where, based on data we have, we believe that they made inappropriate actuarial assumptions regarding interest rates and retirement ages. Through an automated targeted effort to deal with those taxpayers, these additional 10,000 cases will give rise to significant additional revenue.

A third area: Our large cases—these are cases over $1 million or over $10 million in our appeals inventory—have been growing at a rate of more than 10 percent a year. We have about 75,000 cases in the appeals inventory; 3,000 of those cases account for more than 80 percent of the total dollars at issue. By focusing our resources on that limited number of high dollar cases, we think we can get better control of the inventory; we think we can resolve those cases in a more timely fashion to the benefit of the taxpayer and to the benefit of the Government; and that will contribute significant additional revenue.

Mr. ANTHONY. What you say makes an abundance of sense, and I could not disagree with any of it. The only thing I query is why in 1990 are we suddenly taking this tack when these cases have been on the books for a long period of time. And I just don't understand why——

Mr. GOLDBERG. Mr. Anthony, these are efforts that the agency has been working toward and developing for a number of years. For example, the trend in the growth of inventory and——

Mr. ANTHONY. So you just see the trail coming to the end on some of these complicated cases?

Mr. GOLDBERG. Yes, sir; I am just here for all the good news to come home.

I am serious. These have been efforts under way. I think that we are focusing more attention more precisely. We are experimenting with different ways of doing that——

Mr. ANTHONY. Well, let me shift a little bit. I hope you collect the money, and I encourage you to collect the money as soon as possible if the taxpayer owes the money, consistent with them pursuing all of their legal appeals.

I am a little bit concerned, though, about the policy. If I am correct in looking at my numbers, the IRS requested more personnel in 1988 in their budget submitted to the Congress than under your budget submitted today. Yet you have a statement on page 8 that says, "I want to emphasize that these initiatives represent the growth we can prudently manage and absorb during 1991. No more, no less."

Your predecessor in 1988 disagreed with that because he was requesting a whole lot more and thought that they logically could do more in 1988.

You are asking for less. There is a hiring freeze on. And now as a policy decision, you are shifting out of other departments into this revenue collecting agency. Are you looking at it from that broad policy standpoint?

Mr. GOLDBERG. Yes.

Mr. ANTHONY. You are not hurting the other programs in order to do this?

Mr. GOLDBERG. Absolutely. And, Mr. Anthony——

Mr. ANTHONY. Because the tone of your total testimony, especially at the very end of it, says that this hiring freeze is going to irreparably damage your agency. That is what you are just telling President Bush. Publicly you have just said to him: Mr. President, if you keep this hiring freeze on on the Internal Revenue Service, I am telling you that this agency is going to be hurt for the long-term future.

Now, that is a strong message for the President to be hearing, and I hope he hears it.

Mr. GOLDBERG. Mr. Anthony, I believe the President's budget for 1991 allows us to lift the hiring freeze, provides for growth in collection, provides for growth in examination, provides for an increase in the level of taxpayer service, and I believe the President of the United States, in black and white in that budget, has said we are not going to put the IRS through any more hiring freezes. We are not going to——

Mr. ANTHONY. Let me just close with this final question. The hiring freeze is still in place.

Mr. GOLDBERG. Yes, sir.

Mr. ANTHONY. So what you have tried to do is construct a management budget that gets around the hiring freeze.

Mr. GOLDBERG. What we have done——

Mr. ANTHONY. Is that right or wrong?

Mr. GOLDBERG. Well, get around—what we have done is we took——

Mr. ANTHONY. The hiring freeze is still in place.

Mr. GOLDBERG. Yes, sir.

Mr. ANTHONY. You have submitted a budget that tries to get around a hiring freeze.

Mr. GOLDBERG. It allows us to lift the hiring freeze, yes, sir.

Mr. ANTHONY. It allows you to lift the hiring freeze.

Mr. GOLDBERG. Yes, sir. Now, we are——

Mr. ANTHONY. If your greatest cost is in personnel——

Mr. GOLDBERG. Yes, sir.

Mr. ANTHONY [continuing]. Somebody in your agency has got to suffer.

Mr. GOLDBERG. What we have done—Mr. Anthony, it is similar to what is done in private business. We have had a hiring freeze for 18 months. Now, you know, we haven't——

Mr. ANTHONY. And you have suffered as a result of it.

Mr. GOLDBERG. The result of that is at least in areas where we have had the freeze, we have had a shrinkage in what we have done. By having that hiring freeze in place for 18 months, one way to describe it—and this overstates it, but one way to describe it—is we have downsized the agency through a hiring freeze to the point where we can pay the people we have, we can spend the money on training that we are supposed to spend, and we put ourselves back into a position where what we have makes more sense in light of what we are spending. The 1991 budget starts from that lower plateau that we have gone to over the last 18 months. It says okay, this is where you are at the end of 1990. We want to give you the money where you are at the end of 1990 to pay your salaries, train your folks, invest in systems modernization, and do those things the right way. Not where we were in 1988, where we are now in 1990.

They then say, okay, that is where you are in 1990. We fund you to stay there. We fund you to invest in systems modernization, and we fund you to begin to restore audit coverage, begin to take a firmer approach on——

Mr. ANTHONY. I just don't understand how you can sit there and say that you are going to get enough funding to increase audit cov-

erage when your own numbers show that the audit coverage has gone consistently down over the last 5 years. You are going to be doing good to hit 0.8 percent on audits with this budget.

Assume I am a gambler. I don't understand why the taxpayers just don't say: I'll take 100 to 1 odds. I mean, that is what this budget is saying to the gamblers out there. My chances of being audited next year are practically zero based on even the low rate previously, or did I misinterpret the——

Mr. GOLDBERG. Mr. Chairman, I think the most important thing that we need to focus on is that this stuff doesn't happen in 1 year. When we hire a revenue agent, we have to train him, we have to work with him and develop his or her skills. And what we are doing with the 1991 budget by increasing by 1,700 revenue agents is investing in capital resources, our human beings.

I sat here with these men—these are career Internal Revenue Service employees—and I told them that this administration was willing to let us hire more bodies to deal with accounts receivable. And they looked me in the eye, and they said: Mr. Commissioner, you want to manage your growth the right way for the long term. And if you take an agency and you try to throw in 3,000, 5,000 10,000 new hires in 1 year, you're not going to run the railroad the right way. You need to manage your growth for the long term.

And the President's budget says, with respect to accounts receivable, that this is the first year of a long-term effort to upgrade and expand the number of folks in our collection function. What I'm saying is you don't get well overnight. You have got to manage your growth. And we believe that this budget reflects managed growth.

Now, as I have said, the budget assumes productivity gains; the budget does not itself reflect costs that we are going to have to incur—for example, increased postage costs and the like——

Mr. ANTHONY. Now, Mr. Commissioner, I have enjoyed the great leisure of the chairman allowing me probably to exceed my time, and I don't want to lessen your enthusiasm for trying to do a good job. But I also want to make sure that it is a good balanced package. So I am going to yield my time, and maybe we will have an opportunity later to——

Mr. GOLDBERG. Mr. Anthony, I appreciate it, and I think you——

Chairman PICKLE. We will come back to Mr. Anthony.

The Chair will recognize now Mr. Dorgan.

Mr. DORGAN. Thank you, Mr. Chairman.

Let me echo Mr. Anthony's interest in seeing you succeed. I think you have a difficult job. The last time you were here, Mr. Gideon was seated to your right, and after you left, I made some remarks about if he hadn't had a gun in your side what would you have really said about some of these questions about resources and budgets.

I understand the difficulty. You would get yourself in a whole lot of hot water if you came running down here as a presidential appointee and said, look, I am not getting any support for doing the kinds of things we need to do. Every Commissioner that I have dealt with since I have been on this committee, since 1983, has told us exactly the same thing, you with some more animation than the rest. All of us like you, so we want you to succeed, and we think

that we can share your enthusiasm. But ultimately, the question is in the doing and not the saying.

The last time you were here, I cited to you a district office in which the accounts receivable accounts have ballooned, and the number of collectors had been cut in half.

Now, the question is: What is going to happen to the number of collectors in an office like that when this budget plays its way through? Are we going to see more collectors to collect an increasing number of accounts or not? Because if not, we are not going to do anything except talk about it.

Mr. GOLDBERG. Mr. Dorgan, I believe you requested information on actual staff and revenue officers by district and by office throughout the country. We are pulling that information together, and as part of that information—it is going to have to be more general at this point, but we will show you the growth that we anticipate, assuming the President's budget is enacted.

Mr. DORGAN. Let me just make one other observation to you. You are one of the only real conservatives to hang around the Hill during budget time. Those folks that run the Star Wars aren't telling us, look, you can't pump too much money in at a time. You've got to have a gradual buildup. You can't just throw money at this stuff.

That is not what they are saying. Take a look at the President's budget on Star Wars, SDI, and ask yourself does he have the same philosophy when it comes to investing in SDI as he has in investing in the meat and muscle of our tax collection agency. It is not there. Heck, they can throw a 20-percent increase at some of those accounts just like that.

So I am just telling you that the same philosophy isn't present if they are talking about building a new fighter or an SDI program as building up the accounts receivable collection for an agency whose accounts receivable is over $80 billion.

Let me just go back, if I can, to this question of accounts receivable. My understanding is that when we sent some staff down to take a look at accounts receivable, we were really trying to know, what do you know? How do you manage accounts receivable, and what do you know about it so that you can manage it effectively?

My understanding is that our folks were given some information about September 1989. What kind of accounts receivable existed in September 1989, and how many accounts existed over $100 million, and you provided some information in that area. And you have just described some of that today.

The question is: What about March 1990? How many accounts do we have over $100 million? And how do you have access to that and how do you manage that? Are there Federal agencies that owe the IRS money in March of 1990?

The reason I ask the question is I want to understand how you manage it, not just with respect to amounts but with respect to age. So what do you know about this month in accounts receivable? How many accounts do you have that are over $100 million owing the IRS at the present time?

Mr. BRENNAN. Let me just describe to you how we try to manage that. As I mentioned when I was here last time, the actual collecting of the accounts is done in our field offices. We do not have the

accounts in Washington. But what we do provide to the field, I believe it is on a semiannual basis, is information on a floppy disk on all accounts over $1 million.

Mr. DORGAN. You provide that to the field?

Mr. BRENNAN. Washington provides that to the field, and we track it to see if it is going up or down.

Mr. DORGAN. Now, what if I come in and I owe you $200 million this month. I show up on your accounts receivable. Is that a big enough amount of money for you to know about?

Mr. BRENNAN. Yes. In the last, I would say, 6 or 8 months, or maybe a little longer——

Mr. DORGAN. How would you know about that?

Mr. BRENNAN. I do get a report on the $100 million and over accounts.

Mr. DORGAN. All right. Now, if you get that report—did you get that report last month, for example, in February?

Mr. BRENNAN. It comes out quarterly. I have not gotten the report for the March——

Mr. DORGAN. So you have a report through the end of December on $100 million and more owing?

Mr. BRENNAN. I don't have it with us, but——

Mr. DORGAN. I understand, but you have one——

Mr. BRENNAN. What it does show, what we are finding—and we have our management folks working on this to try to get a change in the system. Because what we are finding is exactly what I have articulated to you. Just take that one Federal agency. We will deal with that, and they don't owe us any money as far as credits. But unfortunately, when we get that off the books, another one will come in.

Mr. DORGAN. But that is error resolution. That is the sort of thing the lowest grade clerk does in your agency, and they do it in 5 minutes. I am not talking about error resolution.

If somebody comes in and owes $10 or $100 million and they have the wrong account number on it, that is not a big deal. The tax collection agencies in every jurisdiction of the country resolve those errors with low-level clerks.

The question is: In your accounts receivable where you have accounts come in to your attention, on a quarterly basis, which taxpayers owe us $100 million or more, and where those accounts are real, real accounts receivable, you get that report? Is that what I understand?

Mr. BRENNAN. Over $100 million. I see that report.

Mr. DORGAN. And then you determine how those accounts are worked?

Mr. BRENNAN. No——

Mr. DORGAN. Are they routinely worked out in the field?

Mr. BRENNAN. Yes. What I do is, two or three times a year I will have a meeting of the Assistant Commissioners who are here in Washington. I have an Assistant Commissioner of Collection who reports to me on this direct area. There are also seven regional commissioners. I will have a meeting three or four times a year with them together and go over various items. One item we have been going over lately, at our last meeting, is this report I told you about, where we look at—I don't look at the individual cases, sir, as

much I do what is the trend of the dollars in total. Are we making progress in collecting the money? Are we making progress in dealing with the accounting problem?

Mr. DORGAN. How big an account would I have to have with you in order for me to be dealt with on an individual basis at some level comparable to yours?

My question is this: I know that you folks have the queue account, right?

Mr. BRENNAN. Yes.

Mr. DORGAN. A queue account is one that you put accounts receivable in that people really owe the Government, but you don't have time to collect because you don't have enough collectors. And so in my district for example, you know there is a range of accounts that are owed. These aren't error issues. These are accounts that are owed, but you have lost collectors. You only have half of what you used to have. So you take a group of accounts, and you say in essence—it is good news, taxpayers, you are going in our queue account. That means we are pretty much through with you because we don't have the time to work you. So they're queued up here, and they are not going to pay because nobody is going to be working them. And the folks that are left to work the accounts receivable are going to work the ones that are not in the queue account.

That is what I understand to be the case. Is that right?

Mr. BRENNAN. You are basically correct. Just let me add, though, that there is various criteria. Let me assure you that the $100 million or the $10 million and over, you know, do not get in the queue except by some error.

Mr. DORGAN. I understand that. I would hope that they don't get in the queue account.

Mr. BRENNAN. The ones that are in the queue—well, what happens there is you do receive up to five notices, depending on the case. If we can find a levy source during our notice procedure, we will levy on that source and take the money.

Mr. GOLDBERG. Mr. Dorgan?

Mr. DORGAN. Yes?

Mr. GOLDBERG. I think there is a point that may be being missed here. The questions seems to be what do we know about something in Washington, and we do get reports, as Mr. Brennan mentioned. But there are some major players that I know from your own experience you have dealt with. You have got 63 district directors, and you have got division chiefs there that have access to that kind of information on a monthly basis. And whether it is in North Dakota or Texas or New York, if there is an account of that size, that division chief knows about it and action is taken. There is tremendous emphasis in the field on large dollar accounts.

Mr. DORGAN. Except the reason I am asking the question today is that our staff went down last year and said we would like to see these accounts. All of a sudden a safari of people come tromping through with 17 boxes, and it wasn't very clear to anybody that you knew what was there. That is the reason I ask the question.

I think you are saying that the system is being refined and changed so that you get reports. Now, $100 million, is there a safe harbor here? If I owe you money, is it easier to escape your atten-

tion if I owe you only $95 million? I am just trying to understand the system, so that those that owe the most in bona fide accounts receivable are able to get the most attention, and that your resources are used and allocated in a proper way. And from the last time we discussed this, it wasn't clear to me whether this accounts receivable, both sized in terms of the amount owed and also dated in terms of how fresh or stale are these accounts, are managed in a way that most agencies would manage them. And that has not all been clear to me at all.

Mr. BRENNAN. Dollarwise, sir, the largest percent of our dollars are not in the queue. The queue has a high number of relatively low dollar accounts. I could give you, not at this hearing——

Mr. DORGAN. Could I ask that you give me an amount, the aggregate amount that is in a queue and what are the larger sums in a queue so that I have some notion of what is there.

[The following was subsequently received:]

Aggregate Amount in a "Queue"
and Larger Sums in a "Queue"

At the end of February, 1990, there was slightly over $19 billion in total taxpayer delinquent account (TDA) inventory. This figure is broken out as follows:

Active Inventory[1]
$17,443,519,201 or 91%
Queue:
$1,760,903,163 or 9%

As shown above, by far the largest amount is active inventory. Queue cases, which are lower priority work in terms of yield potential, represent a relatively small percent of the total dollars available. Cases in the Queue are those where telephone contacts have not successfully resolved the case, and it is awaiting assignment to the Collection Field Function when staffing permits. The average dollar amount of cases nationwide assigned for further work is $39,000; cases assigned to the Queue average $5,400.

The attached chart shows the queue inventory by dollar range for one typical district office. For each dollar range shown on the left, the value of the median case in that range is shown beside the bar. The percentage of the total district queue represented by that dollar range is shown on the right. As an example, the cases in the $0 - $5000 range have a median value of $1,550 and comprise 73.5% of the district's total queue. The median value of all cases in the district's queue is $2,285.

There are some accounts in the Queue with a higher balance due than some accounts in active inventory. This is because our system takes into account not only the amount due, but also the probability of collecting it. An example of a case with a relatively large dollar amount due that would receive a low priority is a 100% penalty assessment for unpaid employment trust fund taxes (under IRC 6672), where the chance of collection from the responsible individuals is relatively small compared to other cases.

Cases in the queue are subject to refund offset. We also encourage local management to review their Queue inventories and to assign cases to active inventory when the situation warrants such action.

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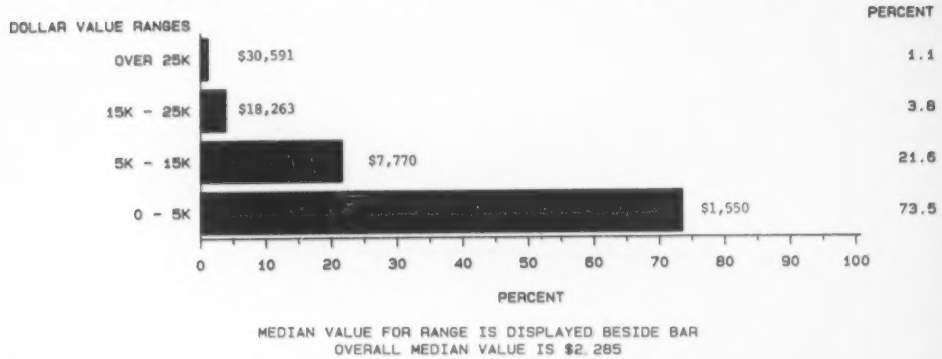
[1] Includes cases in the Automated Collection System and the Collection Field Function.

QUEUE INVENTORY BY DOLLAR RANGE



MEDIAN VALUE FOR RANGE IS DISPLAYED BESIDE BAR
OVERALL MEDIAN VALUE IS $2,285

Mr. DORGAN. Mr. Chairman, thanks for indulging me. I have another subcommittee of Ways and Means meeting across the hall that I have got to be at. If I may ask one additional question, I will be through.

Chairman PICKLE. Go ahead.

Mr. DORGAN. If I could, I would like to get from you your last quarterly report—sanitized, if necessary. You can plug in numbers instead of the taxpayer—on this $100 million or more, because I am trying to understand what it is you know from your report. I am still especially interested in tracking this question. Are there agencies, not as a result of errors, that occasionally show up in this accounts receivable area?

Mr. BRENNAN. There are no agencies that I am aware of that show up in the $100 million and over that owe us any money. Also under that amount I am advised by talking with the field that there are few, if any, there.

[The following was subsequently received:]

LARGE DOLLAR TREND RECORDS

As of September 30, 1989, the IRS had 14 cases in its accounts receivable inventory with an aggregate balance due of $100 million and over. There was no listing for December 31, 1989 since the reports were semi-annual at that time. There was one federal agency in the September 1989 listing. Further analysis revealed that the account receivable was not actually owed; the payment had been misapplied to another account for the same agency. Our initial review of these cases indicated that they included cases in litigation, possible misapplied credits and drug cases.

Beginning with a June 30, 1990 report, we will be reporting accounts of $100 million or more on a quarterly basis. Semi-annual reports on accounts over $1 million are sent to the field to determine the accuracy of the balance due shown or adjustment if necessary.

The following is a summary of the dollar amounts for the 14 cases:

	Aggregate Balance
Taxpayer 1	$150.0 million
Taxpayer 2	$151.1 million
Taxpayer 3	$253.2 million
Taxpayer 4	$114.0 million
Taxpayer 5	$289.6 million
Taxpayer 6	$671.0 million
Taxpayer 7	$294.2 million
Taxpayer 8	$121.7 million
Taxpayer 9	$178.6 million
Taxpayer 10	$124.7 million
Taxpayer 11	$222.9 million
Taxpayer 12	$252.4 million
Taxpayer 13	$123.3 million
Taxpayer 14	$114.9 million

Mr. DORGAN. Just a final statement. Mr. Commissioner, I think you understand this because the flavor of your statement certainly is comforting to those of us who want better administration. Part of it is not just enforcement. We need better enforcement. But part of it is making sure that the "service" is back in the Internal Revenue Service. And service means help. And help means assistance to those people who have difficulty understanding the tax forms.

I had a fellow stand up at a meeting in North Dakota not too long ago, about a month ago, and he said, "I am holding up here a 1946 income tax return from the Federal Government, and I want everybody in the room to understand that this is the return, it is the rate schedule, and it is the instructions." And he held up this little flimsy thing. It was embarrassing; it was so small and so simple.

So I asked my staff to get me the income tax returns from 1930, 1940, 1950, 1960, 1970, 1980, and 1985, just so I could get samples of every decade of what has happened. This form has become a Sears & Roebuck catalog operation that we have created together—Congress and the administrations over the years. And we are literally choking the American taxpayers on some of this complexity. And as it has become more complex, albeit in order to achieve fairness, I suppose, in some cases, it is much more important that we reach out the hand of assistance to people who are trying desperately to comply with tax laws that are very difficult to understand.

Thank you, Mr. Commissioner.

Chairman PICKLE. Thank you, Mr. Dorgan.

Commissioner, with respect to the accounts receivable, though we held a hearing on that recently, I think it is a fact that we ought to recognize that more needs to be done in the area of accounts receivable. I would think the Internal Revenue Service should admit that. When we can walk from my office here down to your office and find boxes unopened, it would appear to us that the Internal Revenue Service has just grown rather inured to the fact that this money is not collectible. You have sent out up to six notices, and you say, well, we have got more problems and we are not going to get that money anyway so you just kind of get tired of the process.

Now, we don't know whether it is $87 billion. We will say maybe it is $20 billion less than that because taxpayers may have died or moved or something, and another additional amount is tied up in litigation or bankruptcy. But you still have got at least $40 billion out there that is receivable that should be collectible. You have got to put more emphasis on the accounts receivable. If you need more manpower, you ought to do it. It may be difficult. But if we don't do that, Mr. Commissioner, in my opinion, the public gets the feeling that there is money out there that you haven't collected, and they are going to stop wanting to pay their fair share. It will hurt the voluntary tax system. So I hope that we can put greater emphasis on this down the street and recognize it has got to be followed through on. If there is money out there, we sure better get it. If it is real dollars, we had better go get it. I don't think I would just try to justify not collecting it. We know it is difficult and that you have tried up to six different times with notices to get it yet you haven't. But if this accounts receivable is real, we ought to do something about it.

Mr. MURPHY. Mr. Chairman, excuse me. There's one point that has been made a couple of times about the boxes of records. And we certainly agree that we have got to get our procedures so they are understood and get on those accounts receivable. I agree with you on that.

But the point about bringing those boxes in, the boxes were brought in for the benefit of the staff. The actions on those accounts receivable are taken out in the field. Somehow, there seems to be an impression that the people in Washington are the ones that are working those cases.

Chairman PICKLE. Mr. Murphy, I believe there were two district offices out there that weren't doing anything out in the field on these accounts receivable.

So, when you say that there is action in the field, in a couple of districts, we found out that wasn't even being done.

Mr. MURPHY. I should have said actions or inactions then. My point was that the boxes were brought in for the benefit of the staff to take a look, Mr. Chairman.

Mr. GOLDBERG. Mr. Chairman, I agree with you it's a very important area. We have a number of what I believe to be significant initiatives underway, and I would be happy to report back to you publicly in 6 months and tell you how much progress we have made.

Chairman PICKLE. You've got a difficult job. You can't get blood out of a turnip, you know. If it's gone, it's gone.

But, yet, a lot of them are going to decide to wear you out and they just won't pay. We cannot let that happen because if you do, you do great damage to our voluntary tax system. So I just caution you, we must be more vigilant in that area.

Mr. GOLDBERG. Yes, sir.

Chairman PICKLE. Now, Mr. Commissioner, let me ask you two or three questions.

One, you pointed out there is a $635 million increase in the budget for next year. That's good and you point out different areas where you hope to have additional funds.

Now, let me just make a conjecture with you. Because we hear rumors, and it bothers us.

If the Internal Revenue Service received, let's say, $100 million less than the administration's request, what portion of the administration budget proposal would not be done? What happens if the budget is cut $100 million? What would you do, where would you cut?

Mr. GOLDBERG. Mr. Chairman, I think that we would have no choice but to start by eliminating the revenue initiative, the $191 million. The President has asked for $200 million to beef up Collection and field Examination. If we don't get that money, then we will not beef up Collection, we will not beef up field Examination. The result will be a continued growth in accounts receivable.

Chairman PICKLE. You will not beef up Collections and, yet, you already cut Collections this past year, Collection and Compliance. So you would be cutting them again.

Now, Mr. Commission, we have heard by the grapevine that you're going to get the budget through here on this side of the House, and that the other body is going to cut it $100 million at least.

Have you heard that rumor?

Mr. GOLDBERG. Sir, I hear all sorts of things every day.

Chairman PICKLE. Mr. Commissioner, suppose they did cut it $100 million, you tell me it's very difficult in certain areas. You'd have to cut areas that already have been neglected.

Suppose they'd cut $200 million out of the budget?

Mr. GOLDBERG. If they cut our budget $200 million, Mr. Chairman, it's going to cost the Federal Government $550 million in 1991——

Chairman PICKLE. How much?

Mr. GOLDBERG. $550 million in 1991. So they're going to save $200 million on our budget, and they're going to lose $550 million in receipts.

Chairman PICKLE. All right.

Well, we'll say there's a problem because, number one, I think you would admit that you're under a great shortfall. You have about a $500 million shortfall around there now. You just have to hope your money is approved so you can pay for what you didn't have this year.

Mr. GOLDBERG. Yes, sir.

Chairman PICKLE. And that's a cold fact, and I don't know what else you can do at this point.

But let me ask you a question now and go one step further in this whole area.

Are there costs that you, you as Commissioner, know that the Internal Revenue Service will incur in fiscal 1991 which are not provided for in the administration's budget, and what are these costs?

Mr. GOLDBERG. Yes, sir. Well, as you know, it is a longstanding policy that pay increases are not fully funded. The President's budget this year funds 50 percent of the pay increase, which means about $50 million is not funded.

There are postal cost increases, as you know, which have been announced recently. And those postal increases will cost us $25 million plus next year.

We have special salary rates next year of $20 million. Increased telecommunication costs. The FTS 2000 system is about another $20 million. We have changes in salary and benefit costs that could run as high as another $50 million. We have computer systems' maintenance that we did not do this year that we should do next year, about $30 million. So I guess that adds up to about——

Chairman PICKLE. $30 million? I thought it was about $50 million.

Mr. GOLDBERG. Well, of that—we're talking about stuff we really need to do. And that adds up to about $200 million.

Chairman PICKLE. You are saying that you're in the hole for about $200 million, and if they cut this budget again, by $200 million, that just doubles your problem, doesn't it?

Mr. GOLDBERG. Yes, sir. But I want to emphasize, Mr. Chairman, we're talking $200 million in a $6.1 billion budget. And we have told the administration, and I believe we can manage better to cover a lot of that $200 million shortfall. We can't cover another $200 million shortfall no way.

Chairman PICKLE. Yes.

Mr. GOLDBERG. Not a chance.

Chairman PICKLE. If you expected to do that, you're in big trouble.

Mr. GOLDBERG. Yes, sir.

Chairman PICKLE. Now, you said in your statement to me earlier that the Internal Revenue Service got the money to implement the taxpayer bill of rights. And we hope that's right.

And you further said that you got all the money you need for the computers.

Now, is it not true though that you, the Internal Revenue Service, appealed to the OMB for $50 million for the taxpayer bill of rights and you didn't get any money for it? And didn't you also face the fact that OMB actually denied $30 million in your appeal for funds for the computers, is that not correct?

Mr. MURPHY. Mr. Chairman, maybe John Johnson, the Chief Financial Officer, can answer.

But I remember last year I testified before you on this, and mentioned that in the 1989 budget we did not ask for the money for catastrophic health and bill of rights, and there was a third one, I believe it was drugs.

We went in for a supplemental that was not approved. So you're right. The bill of rights was not funded. But I think John might have something to add to that.

Chairman PICKLE. All right.

Mr. GOLDBERG. Mr. Chairman, I think the short answer to your question is yes, you are correct.

If I can give you a little bit of a commercial here. When Congress passes laws, it costs us money to implement that legislation. That's just a fact. And it ranges from forms to programs to everything else. And I think that it is appropriate to look at the question.

When you enact the laws, maybe you ought to look at a way to pay for it.

Chairman PICKLE. Did you want to say anything, Mr. Johnson?

Mr. JOHNSON. I think the short answer is always the best answer, Mr. Chairman.

Chairman PICKLE. Get closer to the microphone, will you?

Mr. JOHNSON. I said I think the short answer is always the best answer. But it is true that, in our initial estimates for next year, we had a higher figure for both impact of legislation and computer systems. They were adjusted out of the internal administration process.

I will be happy to give you a reconciliation sheet.

[The following was subsequently received:]

LEVEL OF RESOURCES REQUESTED BY IRS TO IMPLEMENT THE TAXPAYER BILL OF RIGHTS

The IRS submitted a fiscal year 1990 supplemental request for 379 FTE and $36.6 million to implement the Taxpayer Bill of Rights. This request was denied by the Office of Management and Budget. The fiscal year 1991 President's budget submitted in January 1990 also contained a program initiative for 395 FTE and $29.6 million for the Taxpayer Bill of Rights. This request was also denied by OMB. Costs to implement the Bill of Rights are being absorbed with IRS's current budget level.

LEVEL OF RESOURCES REQUESTED FOR ADP MODERNIZATION IN FISCAL YEAR 1991 BUDGET

The fiscal year 1991 budget request to Congress for ADP Information Systems totals 8,088 FTE and $993.9 million. Our submission to the Treasury Department in May, 1989 totaled 9,257 FTE and $1.439 billion. We submitted a request of 8,726 FTE and $1.183 billion to the Office of Management and Budget.

The Department reduced the requested increase by 531 FTE and $256 million, which included a reduction to a portion of the proposed increase for the Integrated Collection System; Integrated Telecommunication System; Real Time Communication System and a request for resources to fund the replacement of laptop computers for Examination personnel.

The Office of Management and Budget reduced our request by 193 FTE and $88.3 million, which included a reduction to a proposed increase for the Automated Taxpayer Service System; Counsel Automated Systems Environment; and the balance of Communication System and Examination Laptop replacement.

Chairman PICKLE. Now, Mr. Commissioner, we are not trying to be difficult about these questions. I'm pleased that the administration has requested more money. I think the American public should be pleased that the administration is requesting more money for the Internal Revenue Service, not a popular thing to do. And I applaud them down the street for doing that.

I also, though, don't want to get lifted up in a state of euphoria that all is settled. You're $200 million in the hole even under the budget request and you've got to make up for what wasn't given to you last year. And, if they cut you out another $200 million, you've got big troubles.

So the request for more money is not that meaningful. It is a help, and I hope we can do that and more. I hope that they listen to you, Mr. Commissioner, and what you're trying to do for the service because the American people are entitled to it.

Now, I think we're making progress. But, I think we've got to go ahead and attend to this thing.

I want to shift gears on you just a little bit here. Well, first, let me yield to Mr. Anthony.

Do you have any questions at this point? I want to come back because I have two or three other questions.

Mr. ANTHONY. I'll yield to the chairman. I think you may be getting into one area that I would like to get into.

But while Mr. Pickle was going through his questions, I did quickly go back and look at the rate of audits. I'll read you these numbers, and then I just want to ask you, what is the acceptable rate today as a policy matter from the Internal Revenue Service's viewpoint?

I don't have the exact year, but the first testimony I heard said that the anticipated audit rate would be 1.6 when the real rate was below that. The next year, they came in and said the expected rate would be 1.27 and the real rate was below that. The next year, the same thing.

If I understand it correctly, you are saying that it will be 1.03. If I am to learn from 3 years' previous experience, it has got to be something below 1.03 that backs up the basis of my statement earlier when I said that some gamblers out there may take the odds at 100 to one because it looks like your actual audit rate may fall below 1.03. And, in fact, I have been told that the current rate is something like 0.8 percent up to date.

Mr. BRENNAN. I don't know what the current rate is right at this moment. We did last year—I think we need to look at, and I can submit this. This is a 1989 return file examination coverage sheet. I think we need to look at it over all the classes.

It is absolutely true that in the individuals, total individuals, it was 0.92. However, when you look down through the individuals in

the higher income tax brackets, it's up as high as 5.4 percent in one category.

When you look at corporations, the overall corporation rate for 1989 actually went up for the first time in 2 or 3 years. It went from, I think it was 1.23 the year before to 2.02.

Mr. ANTHONY. So maybe I had better wait for you to fully explain it to me. If you could place it in the record and send me a copy of how it breaks down overall——

Mr. BRENNAN. I will. We have it going back to 1964, and just so I don't mislead you, it is a whole lot lower in the last 5 or 6 years than it was previously.

Mr. ANTHONY. Well, if you could just, say, take the last 4 years and show me where the audits have broken down by categories, maybe that would satisfy my inquiry and would help establish the record here in terms of where we are headed.

[The following was subsequently received:]

COVERAGE BY TYPE OF TAX—FISCAL YEAR 1981 THROUGH FISCAL YEAR 1989

Fiscal year	Individuals	Fiduciary	Partnership	Corporations	Form 1120S	Estate	Gift	Total
1981	1.77	0.49	1.62	5.05	1.77	18.43	2.74	1.84
1982	1.55	.53	1.63	4.74	1.60	16.73	2.37	1.63
1983	1.50	.42	2.41	3.64	1.31	16.94	3.59	1.56
1984	1.27	.48	1.57	2.66	1.02	17.14	2.23	1.31
1985	1.31	.39	1.42	2.39	.97	21.33	2.11	1.34
1986	1.10	.35	1.00	2.20	1.08	20.80	1.90	1.12
1987	1.09	.22	1.15	1.58	1.12	22.36	1.65	1.10
1988	1.02	.18	.79	1.37	.99	21.45	1.45	1.02
1989	.92	.12	.72	2.01	.66	23.97	1.23	.93

Although our fiscal year 1990 budget called for an audit coverage of 1.02 percent, resource shortfalls and hiring restrictions prohibit us from achieving that level this year. We estimate that audit coverage will be approximately 0.83 percent. The actual figure will not be available until the close of the fiscal year.

Chairman PICKLE. Would the gentleman yield?

Mr. ANTHONY. I yield.

Chairman PICKLE. First, let me say to you, with respect to the audit rate, in my opening statement, I expressed my very grave concern about the fact that the rate of audit is going down. And Mr. Anthony just listed some of those figures.

It is now below 1 percent apparently. He said it's 0.8, and the Internal Revenue never did give me a figure. You may not know, but at least it's 1 percent or less, is it not?

Mr. BRENNAN. Yes, sir.

Chairman PICKLE. All right. Now, that area is going down, down, down. And the question is, would we get to the point where we won't have any audits? Of course, that would be unthinkable.

I raised a question to you, Mr. Commissioner, earlier, have we reached the point, or are we reaching the point where we will have to put a floor on the amount of audits?

Yesterday, or day before yesterday, in the Ways and Means markup of the customs bill, we actually put a provision that says that the Customs Office has got to spend a certain amount of money on commercial operations vis-a-vis the noncommercial. We

put a floor under it. We just said you just can't get this money and spend it for other purposes.

Now, we may do the same thing with the audit level. Can you comment on that? Would you venture that we should have some certain level? It's going down now to where it's less than 1 percent.

What is your position? What is the Service's position about what we should have?

Mr. GOLDBERG. Mr. Chairman, I think that an adequate level of audit coverage is essential to the health of our system. But if you start telling us that we ought to take money out of taxpayer service, and ought to start taking money out——

Chairman PICKLE. Oh, now, Commissioner, you know that all the time, you're shifting the funds around. And I'm not going to let you just say that you would take it out of taxpayer services. I just say don't pit one against the other. Just tell me how we can handle it.

Mr. GOLDBERG. OK. If you are talking about extra money to increase the audit coverage—we're not robbing Peter to pay Paul here, we're talking about more funds to increase the audit coverage. The administration's budget for 1991 funds the amount of growth that we can rationally manage.

Now, shall we grow again in 1992 and grow again a little bit more in 1993, and get back up to 1.5 percent? Sure. But we've got to do it a year at a time, and we've got to do it properly.

Chairman PICKLE. Now, the question is should we have any kind of floor? I asked if we should say that at least so many people are going to be audited? And you say, well, we could do that if we take it from all these other sources. That's true.

But what happens when the American people think, well, my chances of being audited are going to be mighty slim. Most of the time you have an audit, it's based on the computer telling you that there's a reason maybe to have an audit. Some document is not prepared, or he's been a violator before, or there's a suspicion about the return. So, that person is audited.

The average person is not audited. Now, should we have a certain amount of random audits?

Mr. GOLDBERG. Can I comment on that? I think that the tax system has changed a lot over the last 10 years. Right now, 40 percent, that's 40 percent of the American taxpayers file tax returns that use information return documents, essentially the only thing on their return. They've got wages and interest and dividends and, you know, home mortgage interest deduction and a State income tax refund, that's all that's on their returns.

We match all those documents. So, that for 40 percent of the American people, the effect is we look at their returns every year. And if they forget to report $500 interest income, we send them a letter. Now, that's not an audit. We don't call that an audit. But if you get one of those letters, you know the IRS has been looking at you.

So I think we need to keep that in mind.

I think that a floor under the number of audits would be a mistake, because I think the situation changes. As Mr. Brennan pointed out, corporations and high income taxpayers audits, I mean there are different issues for them than there are for wage earners. And I think you couldn't set a single floor that would work.

But I think we ought to grow, and I think we ought to start growing this year.

Chairman PICKLE. Well, I think the point I make again to you is that we are concerned, and you're bound to be concerned, that the rate of audits has gone down, down, down.

Mr. GOLDBERG. Absolutely.

Chairman PICKLE. We have to establish a policy that we do not have now. I don't know what that level is, but we need to have your advice and suggestion on how to do it.

Mr. Anthony, I thank you for yielding, and I yield back to you.

Mr. ANTHONY. Mr. Chairman, I just have one other area that I would like to get into with the Commissioner. And I am not sure that we may have time to fully flush it out. But at least I would like to find out what the Service is doing at this particular time.

My question concerns U.S. subsidiaries of foreign-owned companies. More recent accounts have shown that they are enormously profitable entities, yet they are paying very, very small amounts of Federal income taxes. And I guess what I am trying to find out, do you have a special emphasis on this? Do you have a special initiative working on this? Have you allocated personnel into it? Have you targeted the industry groups, and have you had any success by industry group or by a specific corporation, or do you even think it's a problem?

Mr. GOLDBERG. Mr. Anthony, the data, the information that we have suggests quite strongly that, on an industry-by-industry basis, foreign-owned U.S. companies have lower effective tax rates than their U.S. based competitors.

Now, that may or may not—I mean there may be perfectly reasonable explanations for that. The foreign-owned companies may be spending more money on R&D, or they may have newer equipment that they are still depreciating. It could be perfectly appropriate.

But there's a big difference there, and we are looking at it very carefully. And we are investing significant resources in that question. We have a significant number of cases that we are looking at. We are focusing on it on an industry-by-industry basis.

So it is an area of concern. It is an area of emphasis, and it is an area that we are investing a fair amount of time and attention to.

Mr. ANTHONY. Well, I will just close with this. Are you satisfied that you have the proper amount of tools? Is there anything that this committee could take a look at in terms of providing you with additional resources, or maybe even taking a look at some of the tax structure itself if, in fact, everything that they're doing is legitimate?

I want to tell you what bothers me. I'm going to take a look at the foreign automobile manufacturers operating in the United States. If my information is correct, since they are able to earn more than $7.7 billion in profits, yet they only pay $12 million in U.S. taxes, while the U.S. automobile companies pay 530 percent more in taxes than the $12 million.

All I am looking for is a competitive level field when it comes to the tax structure.

Mr. GOLDBERG. Mr. Anthony, I believe that the hiring freeze we've been living under—when I showed you that number—we cut

back money and expert witnesses. Expert witnesses are critical in these very big, very complex cases, and we are accountable for this.

I believe that when we made cutbacks in the 1990 budget, and you talk about the hiring freeze, obviously that has had an impact on this program just like every other program.

And when the chairman asked about our 1991 budget and what's going to happen, if we don't get that 1991 budget, we are not going to be able to pay for the experts, and we are not going to be able to pay for the training that is going to let us do the kind of job we need to do here.

Mr. ANTHONY. So the conclusion of your statement and the import of Mr. Pickle's rumor, if the Senate then does force a $100 million or a $200 million shortfall in your budget as requested, and if we cave into that, basically what we are saying to domestic corporations, if you're bucking foreign-owned subsidiaries doing business here, then you're not getting much relief from your own Government in terms of trying to keep that playing field level.

Mr. GOLDBERG. Mr. Anthony, you're saying a little bit of that. You're telling a little bit to those folks in North Dakota. They may not get their phone calls answered as quickly as——

Mr. ANTHONY. The wait time may get longer?

Mr. GOLDBERG. Yes, sir.

Mr. ANTHONY. All right.

Mr. GOLDBERG. That's what you're saying.

Mr. ANTHONY. I think you've laid it out there very succinctly that what you are saying, this is a bare bones budget, and if it gets cut below that, then you're going to see some serious damage, and you're already concerned about the damage that's been created because of past budgets?

Mr. GOLDBERG. Yes, sir.

Mr. ANTHONY. Thank you.

Chairman PICKLE. Now, Commissioner, let me ask you a question on another field.

Yesterday, I believe the majority leader, Mr. Gephardt, and Mr. Rostenkowski and some others of us on the committee, introduced a bill pertaining to the question of the corporate tax avoidance by U.S. subsidiaries of foreign-owned companies. That's an ongoing question.

Now, year after year, these foreign companies operate in the United States, apparently earning billions of dollars in profits. It is alleged they aren't paying their fair share of U.S. taxes.

As the Internal Revenue Service Commissioner, you have admitted that improper transfer of pricing is a very serious problem.

Can you tell me what is the current policy of the Internal Revenue Service about combatting this abuse? What impact would your 1991 budget request have on the ability of the Internal Revenue Service to actually enforce the tax laws? And, if this violation is going on, or this practice is going on, is there any way we can stop the practice of these companies paying an unfair amount of taxes to the United States? What is the Internal Revenue Service doing about it? What's the status of it at this point?

Mr. GOLDBERG. Mr. Chairman, as I understand it, we have approximately 1,000 of these returns under examination at the present time. And what we need to do from the standpoint of the

Internal Revenue Service is to be sure we do those examinations quickly, be sure we do them well, be sure that our agents are properly trained to do the examinations, be sure that we have the money to hire the expert witnesses to support those efforts. And we need to be sure that we get the job done. And that's what we're doing.

And as I've said, it is an important area. And that is why that 1991 budget is a very important subject.

Mr. MURPHY. Mr. Chairman, if I could add, we've got about 120 staff years of just international examiners involved in that program for this year. Those, of course, are resources that are coming out of our regular audit program.

As far as how much would be used in the 1991 budget, I am not sure if we have a specific number. But it is certainly an area where we have projects involved throughout the country. And as the Commissioner mentioned, you're talking about a thousand returns under examination.

Chairman PICKLE. Is there a practice or a problem out there, in the transfer pricing area? Does the practice exist? Are there violations in that area?

Mr. GOLDBERG. Mr. Chairman, it's an area we're concerned about, and that's why we are examining it. Until we complete more of these examinations, and until we finish more of our work, we cannot answer that question definitively one way or the other.

We are concerned enough to be looking very carefully.

Chairman PICKLE. Well, this may be a bigger problem, Mr. Commissioner, than you or I can anticipate at this point if the practice is going on.

Mr. GOLDBERG. Yes, sir.

Chairman PICKLE. And apparently it is going on, because we have already been working on this for some 3 months in our subcommittee just trying to gather facts.

We recognize that it is complex and that it will take time, especially if we have the difficulty that many of these tax records are not in the United States, and that they are somewhere else in another language.

Mr. GOLDBERG. Yes, sir.

Chairman PICKLE. Now, we are going to be expecting your cooperation. We sent people to one of the Internal Revenue offices yesterday to gather information. We brought back some documents too just to look at and we are going to be doing that regularly.

We want to coordinate with you because this is a national and an international problem. We will be doing that from our committee, and we hope we can be doing some of this work through your office. We're going to look further into this because we think it's a very serious problem.

And as long as our majority leader and the chairman of this committee say this is a serious problem, I think we had better anticipate that it's going to be examined more closely.

So I think you should understand that. And we ask for your cooperation.

Now, you didn't mention anywhere in your testimony today that you had forms that were back ordered. We understand that actually you had back orders, including such things as the W-2 forms,

charitable contribution instructions, quarterly excise taxes forms, and tax information for older Americans. There are about 744,000 different forms and instructions that were back ordered.

Why is that? Is that normal?

Mr. JOHNSON. Sir, there were some back orders on the date you mentioned. For example, the W-2 forms, though, were back orders of 1990 W-2's, not those used for filing 1989 returns, but those that will be used either for employees who terminate during 1990, or for the end of 1990.

Practitioners are now beginning to place their orders for those. If you took those out and you took out the W-2P's, the balance of the back orders looks approximately even with last year's experience at this time.

Chairman PICKLE. Well, the fact is that you have had back orders on several of the forms. I just wondered why would you? In some cases, you didn't have them on file. In another case, you didn't order enough of them to begin with.

Why would you underprint?

Mr. JOHNSON. On the 1990 W-2's, sir, we chose—possibly an incorrect decision—but we chose to go to print with those a little later in this year than we did in our comparable experience last year. And that's why they pushed the number up.

Chairman PICKLE. Well, each year it seems like when we have one of these hearings, we have instances that we know of where people walk into the office and they don't have the forms.

I can't imagine going to an office and not have a W-2 available. But it continues to grow.

And I have wondered, are you just underestimating, to begin with, the amount you need, and somehow then don't get enough supplies out in the field?

What is the problem?

Mr. JOHNSON. No, not underestimating, sir, because normally at the end of the year, we have considerable inventories of excess forms available.

This year, as in last year, we had a very aggressive quality control program going on in the districts and all the postal units around the country. And both from our records and GAO findings, the quality in terms of the right forms being available and the number of forms being available is really very good this year.

Chairman PICKLE. What difficulty have you experienced now with respect to that section of the tax form pertaining to the catastrophic premium, and the fact that taxpayers didn't have to fill it out? That was due to late action by Congress. We did make that decision too late for your forms to be changed.

Now that we have tried to inform the public, has that been a serious problem for you to administer.

Mr. GOLDBERG. Charlie Peoples, our Assistant Commissioner of Returns Processing. Charlie.

Mr. PEOPLES. Mr. Chairman, that has not been a problem. Taxpayers who have paid in estimated tax payments anticipating that law will get that refund back as they file their returns. And we haven't had any indication that there has been a problem.

I think, as you know, there was an extensive publicity campaign on that issue and it has not been a problem for us.

Chairman PICKLE. Well, I am glad to hear that. We were fearful at first that there might be a source of irritation to the taxpayers. But the public has pretty well understood and, you report that is not a difficult problem at this point. Let's ring the bell on that one then. I'm glad at least that much is working out.

Now, I said to you earlier, Mr. Commissioner, that I didn't know what you were going to do. You had a $200 million shortfall. Actually, it's not $200 million, it's about a $470 million shortfall. Is that not correct?

Mr. GOLDBERG. For 1990?

Chairman PICKLE. Yes.

Mr. GOLDBERG. Yes.

Chairman PICKLE. Well, now, can you add anything further to that question about what we're going to do about it? Can you give us any further hope that this extra money in 1991 well really be extra money, and not just be paying for what the shortfall actually is?

Mr. GOLDBERG. Mr. Chairman, with respect to the shortfall in 1990, we have made the decisions that we have described to get through the year. And that includes the cutback in taxpayer service, it includes hiring freezes. So we are going to get to the end of 1990.

By the end of 1990, we will be in a posture if we get our 1991 budget that we can begin to run this agency the right way.

Chairman PICKLE. Well, we know what that kind of a shortfall is, some $470 million. If you are just trying to catch up next year, you admitted that you have had to cut some services back like taxpayer services, this constitutes a serious problem for us.

Now, the General Accounting Office is going to testify in a minute. As I recall, the General Accounting Office has testified on one or two centers that they've looked at, they actually found that you have people out there examining 1987 returns who had no training on the 1987 tax law changes affecting these accounts

Next, we will listen to GAO. But if you want to comment on GAO's findings now, it will be fine. But if there was no training, then it is obvious that you've got to have more funds for more people.

Mr. BRENNAN. But at the national level, sir, we did issue instructions, and we held enough money so that that should not have happened.

I will definitely look into it. And at this point I believe it to be isolated instances, but I will definitely look further.

Chairman PICKLE. Did you intend to say something, Commissioner? I didn't mean to interrupt.

Mr. GOLDBERG. No, sir. I think Mr. Brennan covered it.

Chairman PICKLE. One other question.

The administration's budget shows a $2.5 billion increase in revenue collected by reallocating existing resources into areas which have a higher revenue yield.

Now, is this good tax administration policy?

Mr. GOLDBERG. Yes, sir, it's very good tax administration policy.

Chairman PICKLE. In what areas are you putting more emphasis for a higher yield?

Mr. GOLDBERG. There are three areas. First, we have a backlog of tax shelter cases, pre-1987 cases, that we want to move out of the system as quickly as possible, collecting the taxes due and owing.

Second, we have had a very large growth in our appeals inventory in a large case area. We need to move those large cases to settlement, proper settlement, as quickly as we can.

Third, there are certain kinds of defined benefit pension plans. There are 250,000 of them in the country. We had an audit coverage of about zero on those plans. We are increasing our audit coverage in those plans to about 5 percent. And we believe that is an important area meriting our attention.

We are not talking about significant redeployment of resources. We're talking about staff years that number in the hundreds to accomplish this.

Chairman PICKLE. Well, you're trying to implement a policy that would get this money in.

Are you doing that in the fields of accounts receivable?

Mr. GOLDBERG. Yes, sir. Accounts receivable is a very significant item. We have three or four different projects underway to deal with the large dollar accounts, deal with the currently noncollectible accounts, deal with the processing issues, the disputed accounts in the service centers. And I anticipate that we will be making significant progress over the next 6 months in that area.

Chairman PICKLE. When you listed the areas of activity, you did not list anything about accounts receivable, as I recall your statement. Now you're saying that we are doing that. I would like to have a report from you on accounts receivable, what you are doing, what you expect to be able to accomplish and a time schedule, and your estimate of what you think could be done about it.

Yes, sir.

Mr. BRENNAN. Mr. Chairman, we are putting together to submit to the committee an action plan covering, I believe, the seven points that you made.

I would also like to mention though one thing which just occurred to me. In the budget area, we were able to allow our answering sites, ACS sites we call them, to begin hiring some people. I believe we started about a month ago to release them from the freeze up to a certain point. And that's where we deal with the accounts receivable and collect them.

[The following was subsequently received:]

On January 17, 1990, we released the hiring freeze from ACS personnel and authorized the hiring up to benchmark levels for the fiscal year. All the regions have indicated they will realize their allocated ACS staffing due to this release of the freeze.

Chairman PICKLE. Well, we would like to have a report on that from you.

Mr. BRENNAN. Yes, sir.

[The information follows:]

Accounts Receivable
"Seven Points of Concern"

1. IRS does not have adequate information management systems in operation.

a. We now have a "vital few" project concentrating on four areas which are crucial to improving management of the accounts receivable inventory. One of them is a three stage process to develop a better Accounts Receivable management information system:

i) Stage 1 is an interim system to provide accrued penalties and interest data, provide an Allowance for Doubtful Accounts (ADA) estimate, and recategorize certain receivables. The system has been developed to the point where accruals have been added to the Accounts Receivable Dollar Inventory (ARDI) as of September 1989, and Currently-Not-Collectible accounts have been excluded. The ADA estimate will be available in June 1990.

ii) Stage 2 is an enhancement of the current revenue accounting control system to allow additional automation and fewer manual reports. This enhancement is to be completed by June 1994. The evolution of the current revenue accounting system to a service center support system is to be completed by 1995. We will also complete conversion to a government-wide standard general ledger.

iii) The longer term effort is a transition to a full-scale modernized tax system which will provide better accounting for ARDI on the master file, prevention of errors from entering ARDI, access to all taxpayer information to all IRS employees with appropriate clearance to speed resolution of problems.

b. Other activity has begun to make interim improvements: improved analysis and oversight, development of procedures for use of the Large Dollar Trend Records (LDTRs), possible transmission of the LDTRs and other accounts receivable data to the field via modem, and modification of accounts receivable reports to include additional information.

2. In 1977, the accounts receivable inventory was three percent of Federal receipts, four percent in 1983, and eight percent in 1988.

a. Several reasons for growth in accounts receivable have been identified: the increase in the average dollar amount of delinquent accounts, the increase in the amount of recommended delinquent assessments, the change in the

reporting of 100% penalty amounts, the addition of windfall profits taxes and various civil penalties, the change to the FTD penalty rate, the change to compound interest, the growth in compliance activities, the increase in bankruptcy and litigation cases, and an increase in the average dollar value of currently-not- collectible cases.

3. Statue expired cases.

With certain exceptions, the statutory period for collecting a tax liability is six years from the date of the assessment. Information on the collection statute expiration date (CSED) is recorded on each delinquent module of the master files. Analysis of this information yields systemic monitoring of CSEDs. Accounts assigned to the Automated Collection System (ACS) are monitored through the issuance of weekly reports which identify cases needing timely action to prevent the statute from expiring. Accounts assigned to district offices are monitored through the issuance of monthly reports which similarly identify such cases.

In the event an assigned case has the collection statute expire without appropriate action having been taken, a report is submitted to the district director or service center director where the case is located. The director evaluates the report for the cause of the problem. If systemic problems are identified, they are forwarded to the appropriate area for correction. In the event of negligence, the responsible employee and managers may be subject to disciplinary action.

For certain categories of accounts, no action is taken to prevent expiration of the collection statute. Low dollar accounts below criteria for ACS processing are deferred after the billing process. Cases that have been processed by ACS but whose expected yield does not warrant field contact, based on current workload and resources, are maintained in the Queue. These deferred and Queue accounts are returned to the collection stream if subsequent tax periods raise the total balance above the deferral level or the Queue cutoff score. These accounts are subject to refund offset and an annual notice but no action is taken to prevent statute expiration.

Of all accounts where the collection statute expires, most are classified as currently-not-collectible. These cases have been worked and assigned to this status. Systemic checks are made to monitor these accounts. Various factors can lead to reactivation. Accounts may also be scheduled for review at certain dates. These accounts are also subject to refund offset, but if reactivation is not warranted, no action will be taken to prevent statute expiration.

On cases where the Service believes further action is

needed, the taxpayer is requested to extend the statutory period to allow more time to resolve the account. If the taxpayer does not agree to an extension, levy action can be taken prior to the CSED which would extend the statutory period with regard to the levied property. Also, if there is good and sufficient reason to believe the taxpayer's account will be collectible in the future, the Service may file suit to reduce the tax debt to a judgment. On cases where a judgment has been granted, the Service may continue to take administrative action, including refund offsets and distraint, to collect the liability.

4. Large Dollar Cases

a. Very often large dollar taxpayer accounts do not reflect amounts that are actually owed. Some reasons for this are: deposits are not properly credited to the correct EIN, taxpayer or IRS errors in filing or processing the returns or deposits, discrepancies in reconciling Forms 941 and W-2s, deposits made but the return not filed. In addition, often large dollar amounts that are in ARDI will not be collected. Some reasons for this are: taxpayers are in bankruptcy or litigation, cases are being appealed, taxpayer has no assets or address is unknown.

b. Activity to close out 14 cases over $100 million - Attachment 1 is a copy of the letter we furnished the Committee previously on this topic.

c. Information on 10 cases from $10 to $5[illegible] million - Attachment 2 is a copy of a letter we furnished the Committee previously on this topic.

d. Activity and dates to "clean out" $14.5 billion by the end of the fiscal year - Another set of reports on the status of large dollar cases (over $1 million) will be transmitted to the field by the end of April. The field will be responsible for analyzing these cases and reporting to National Office the problems they encounter with these large dollar cases so that we can remove as much of the $14 billion as possible from the inventory.

e. Plans/dates to prevent problems from occurring - The "vital few" project team is concentrating on reporting procedures, problems caused by multiple identification numbers, and preventing unnecessary assessments. An action plan is expected by the end of April. A large dollar team is exploring appropriate actions that can be taken to reduce the amount of accounts receivable comprised of large accounts.

5. Cases in Collection Queue -

a. Queue figures - Attachment 3 provides data on amounts in the Queue by district and region as requested.

b. Workload allocation system, tie in with hiring revenue officers - Collection is currently developing a forecasting model that will be used to project workload and revenue; the model will be used, possibly for 1991, to allocate resources based on the RWMS workload (inventory and issuances).

6. Collection staffing issue.

a. IRS did cut in half a 1990 revenue initiative, resulting in a revenue loss of over $100 million.

b. We have requested a 6 percent increase in staffing for the IRS Collection programs for fiscal year 1991.

7. GAO concern with Collection strategy.

a. The IRS is studying the effectiveness and efficiency of all its Collection programs, as well as other compliance programs, as part of its quality improvement initiatives.

b. ACS effectiveness has been the subject of study recently. Problems have been identified and long-range solutions are being developed. Collection has set Annual Business Plan goals of increasing dollars collected per staff year in all its functions.

c. IRS is concentrating its accounts receivable management efforts in the "vital few" project: analyzing the currently-not-collectible cases and large dollar cases, testing a new service center function as a focal point for resolving accounts receivable problems and implementing new management information systems for accounts receivable.

Chairman PICKLE. Now, Commissioner, the Internal Revenue Service said that you expect to examine about 18,000 small retirement plans in fiscal year 1991. That's part of your fiscal 1991 revenue initiative.

We have had complaints by certain small businesses that the Internal Revenue Service is unfairly targeting them and applying unfair actuarial assumptions in denying plan contribution deductions.

If that is so, why is the IRS undertaking this initiative? And would you describe that initiative?

Mr. GOLDBERG. Yes, sir. Several points I want to emphasize.

First, the universe, the total number of these plans out there is 250,000. So we are talking about a very small percentage of those plans that we are looking at.

Second, we are talking about issues where we believe these plans to be wholly inappropriate, much too aggressive positions regarding certain actuarial assumptions. To date, these cases that we have pushed to the courthouse step, the taxpayers are conceding, entirely agreeing that we are 100-percent right on these issues.

In other cases, where there are legitimate factual disputes, we are settling these cases. We have no interest in squeezing the last drop of blood out of these people. We want to be reasonable. We are willing to entertain settlements where appropriate. But it is clear that there are significant tax dollars at issue there.

Chairman PICKLE. You have undertaken an initiative to try to do something about this in those very limited areas?

Mr. GOLDBERG. Yes, sir.

Chairman PICKLE. As you do that, would that have any effect on the overall problem, on the resources that you should be giving in the larger employee plans? Will that slow down the work in those fields?

Mr. GOLDBERG. No, sir, I do not believe it will. This is a correspondence-intensive program and it's a short-term effort.

Chairman PICKLE. I know we've held you a long time, but let me ask you one big question, another quick question or two.

Your most recent analysis shows—this relates to computers and the big steps we must take. Your recent analysis shows that the mainframe computer in the largest service center should have enough capacity to support processing through 1992.

During 1991, what are you going to do to ensure against capacity shortages and operational disruption after 1992? Do you have any specific schedule with dates and milestones for implementing initiatives to ensure sufficient computer capacity?

Mr. GOLDBERG. Mr. Chairman, I would like Mr. Philcox, our Chief Information Officer, to answer that question.

Mr. PHILCOX. Mr. Chairman, we have analyzed that if we did nothing with the largest mainframe computers that we have in our largest centers to try to improve the capacity on them, we would not have capacity beyond 1994.

However, we have endeavored to have a number of quantified objectives to improve utilization of those computers and, in fact, have improved that utilization pretty dramatically in the last couple of years.

Those quantified objectives will get us through 1994 without any major interruption in our computing capacity.

There are also some unquantified objectives that we could put into being if we needed to get us beyond 1994. However, it gets to the point where you have these large computers and it doesn't make sense to put money into them any more or to try to improve your processing on them because that's very expensive compared to buying new gear.

Our 1991 budget begins the process of replacing that gear in the service centers. We have an initiative underway to procure new mainframe gear for our service centers. We expect to have that procurement on the street this year. And we expect to have that procurement concluded in time to replace that equipment that we currently have at risk.

Chairman PICKLE. Review for me what amount you asked for in the field of computerization improvement for this next budget? How much is in your budget for the next year?

Mr. PHILCOX. For fiscal year 1991, our modernization program asks for $247 million.

Chairman PICKLE. $247 million?

Mr. PHILCOX. Yes, sir; $40 million of that is specifically to replace the gear in the service center.

Chairman PICKLE. I thought it was a less sum than that. But you say it's $247 million.

Mr. PHILCOX. Yes, sir. That's modernization initiatives.

Chairman PICKLE. All right. Now, 247, that's just the beginning, and would you anticipate that same amount of request for the next 5 years?

Mr. PHILCOX. We would expect that in the ensuing periods, that need would probably increase for modernization.

Chairman PICKLE. All right. And in the next 5 years, what do you need to modernize your equipment?

Mr. PHILCOX. Our estimates at this point, Mr. Chairman, the next 5-year period, I can't give you an exact answer.

Over the life cycle of tax systems modernization, we expect that to put the system in place, what we need to provide the level of service to the American taxpayer, what the private sector financial firms provide today, will cost us about $5.5 billion.

Chairman PICKLE. All right. I didn't think you were going to finally get that figure. You went all around the barn two or three times. [Laughter.]

$5.5 billion. Now, if it's 5½, and it will be more, you and I probably recognize it will be considerably more, that's going to be the largest undertaking by any Federal agency of a nondefense category.

Mr. PHILCOX. Pretty large, sir, yes.

Chairman PICKLE. And it's got to be done right. You can't get snarled up with a lot of dead machinery at the Internal Revenue Service.

Mr. PHILCOX. Yes, sir.

Chairman PICKLE. We've got enough problems without having bad tax returns data.

That means we are going to be embarking on the most ambitious and necessary undertaking we have ever had in this agency. The

American people should understand that, and the administration, and the Congress must understand that. The steps have got to be taken.

Now, as we move forward in that field, I am concerned, as the committee is concerned, will the taxpayers have a feeling of certainty and confidence that the system we've got will be working, will stay in place properly? Do we have any fears that something might or might not happen in 1992 or 1993.

Now, you just gave me the assurance that we are going to do all these things. Say it again to me now in plain Texas language so I can understand.

Do you think American people feel that you've got equipment that is going to hold up and won't break down, and that we're in good shape?

Mr. PHILCOX. Mr. Chairman, any time you're dealing in an area that is this big and this large and this complex, there's always uncertainties, and there's always risks.

What we have done is we have begun the planning process to make sure that we manage those risks to the satisfaction of the American public. Our goal is to maintain the service level and better the service level that we give the American public today. And in that regard all of our strategies are developed to accommodate that and to achieve that goal.

That includes things like, when we install new systems, we keep our old systems in operation in parallel to ensure that the new systems work before we cut the switch. So I can give you assurances today. I can tell you that if we do the job right, if we follow the planning process that we have laid out in our management plan which has been completed now for some time, we will minimize the risks to the American public. And we hope to utilize the dollars that we get for this effectively.

Chairman PICKLE. I would like for you to submit to our committee, just so we will have an overall outlook on an annual basis, the amount of money you are requesting for this next budget, and then the next 5 years that follow. You said $247 million, then you said that might go up in the other years.

I would like to know what it will be for 1992, 1993, 1994, and so forth, to complete the cycle. At least at this point, as we move forward, we will have the best estimate that you have. And that way we can bring that amount to the Congress' attention. And you can keep the administration informed and on track, if you will.

Mr. PHILCOX. Mr. Chairman, we would be very happy to submit that information.

Chairman PICKLE. All right. Thank you.

[The information follows:]

Specified below is IRS' budget request for fiscal year 1991 through fiscal year 1996, as detailed in the fiscal year 1991 budget submission to Congress. These figures will change as the Service goes through the formal budget process with the Treasury Department and the Office of Management and Budget.

Fiscal year:	*Millions*
1991	$247,878
1992	524,294
1993	614,935
1994	739,666
1995	861,256
1996	539,989

IRS' preliminary estimate of the cost of Tax Systems Modernization is approximately $6 billion. This estimate includes only the acquisition and one-year operation and maintenance costs of the new system in 1998. We can provide full life cycle costing to you after September 30, 1990, when we complete the Design Master Plan.

Chairman PICKLE. Now, let me see if I've got any other questions here. I did have one more question.

Mr. Anthony just came back in. Do you have any questions at this point? Let me make a statement before Mr. Anthony states his questions.

Mr. Commissioner, I want to say to you that I'm personally pleased at the emphasis that you have put on taxpayer services, and the approach you are trying to make in other categories. I think you're showing initiative and you're trying to do it. I hope that the administration down the street will back you up and support you

I'm pleased again to note that they did request additional money. But that's just kind of makeup for the shortfall money, well, over half of it is. And while I want to say thank you from my part of the country, we would almost be tempted to say thank you por nada because it is not enough. But it is a progress. I hope you keep it up, and I hope you keep making advances in the taxpayer service category.

We have made great improvements in the last 3 years in that category with Mr. Gibbs' advocacy, and your continued advocacy. Yet this past year you've had to cut taxpayer services back. There's no justification for that. The best thing we can do is to give additional funds for the taxpayer services.

I think my center in Austin, Tex., is doing that. I think they're showing as much initiative in that field as any center in the United States, and I'm proud of that. And the reaction in the public is good. They put on a county fair and they washed cars, and they had people come in. This last month we had over 700, 800 that people came out here one weekend to get some help from our service center.

That's good, and we ought to encourage the continuation of that all across the land. But you can't do it if we cut your money, or if you have to cut it, because of shortfalls in other areas, then the system is not working right.

So, I just implore you, when you find there is a gap there or a disservice to the American public, I wish you would tell our people because you'll know before we will. And we will try to do something about it if we can. But you have got to give us some assistance.

I think you want to do that and I am confident that you will give us good cooperation. I'm pleased to note that personally and to thank you for it.

Now, Mr. Anthony, do you have any questions at this point?

Mr. ANTHONY. Well, I guess something that kind of concerns me, the staff just handed me this, and I assume you all have already had a chance to look at it.

Well, unfortunately, all the good that you've probably done in your testimony will only be absorbed by the people who have attended this hearing. And all the millions of people who read Money magazine are going to dislike you as soon as they get through reading this article. So, again, we have a lot of education to do.

But I guess it ought to be fair for you to be able to give a public response. It says the IRS mess, fight back and win. It says, "Dear Readers: IRS will demand more money from one out of four of you this year and next. Don't panic and pay. Around half of those IRS letters will be wrong."

Did you read the story on page 84, "And Fight Back." I have not had a chance to read the article, hoping that you may have read the article.

Is there any public comment you would like to make in response to this article?

Mr. GOLDBERG. Sure. Mr. Anthony, I would like to start by saying that the Money magazine article lays out very clearly and very correctly how the taxpayer ought to deal with the IRS. They tell them to get back to us quickly, answer the first time we write, keep the records. And I think it's good advice.

It's also the advice we've been giving for years. I think with respect to the suggestions that we need to invest in modernizing our systems, and provide better facilities and more training for our employees, that's what we've been saying all morning.

I think to the extent there is a suggestion there that we are collecting money that isn't owed, I think there's a mistake. I think they misread the General Accounting Office report entirely. It has no relationship to what they are talking about.

I think the money we do collect is money that is, by and large, owed to us. And I think it is troublesome and a matter of fair play that they don't even mention the fact that this year we sent the American taxpayer $6 billion that they overpaid. We found the mistake, we caught it, and we sent them their money back. And the article doesn't even mention that fact.

Mr. ANTHONY. Well, you don't sell magazines by talking about the good things that you are doing in there, Mr. Commissioner, so I can understand the dander getting up. [Laughter.]

Ours gets up a little from time to time too.

Mr. GOLDBERG. Yes, sir.

Mr. ANTHONY. I will read through it, and I hope that we've answered in a positive way all of the criticisms that might be laid out in here.

And I guess the one that I will consistently hope that we will always look at, and that is going to be your long-range modernization of your computer system. You have pretty much laid it out, that if it works, you are going to be a viable agency. And if it doesn't work, you think you are just going to be mired in a great deal of chaos down there.

I think there is a lot of evidence that's out there that backs up that sentiment. So, if there is any one area I personally would like to work with you and your staff to make sure that the four points

that you have identified, two of which are legislative matters, are accomplished.

But you should take heart in the fact that there's some very nice complimentary statement in GAO's report in terms of your attitude, your management initiatives. And I hope you take our line of questioning in the same vein.

I am personally impressed with you and your staff. And I must admit that, from time to time, I have been the beneficiary of making an error that you did write back and brought it to my attention. But it was in my favor, so I am one of those few that you've caught.

I am always impressed with how good a job you can do with how much volume you have out there. But our job is oversight. It's to not look at the good things.

Sort of like Money magazine, we brag about the good things, but then we spend the next 4 days looking at the places where we can improve. And I think that's the attitude that you bring, and I think it's a very healthy, refreshing attitude.

And I, as one member of this committee, want to assist you and hopefully make you a good commissioner, and let you brag that you were a really good commissioner when you decide to leave the public sector.

Mr. GOLDBERG. Mr. Anthony, thank you. Just a couple of comments.

One, I think that——

Chairman PICKLE. You better stop right there. [Laughter.]

Mr. GOLDBERG. No, no. No, no. Mr. Chairman, I know I should stop. But there are 120,000 people working in this agency, and I think everyone of them deserves a vote of thanks. But I appreciate what you're saying.

Chairman PICKLE. Well, I thank you, Mr. Commissioner.

In that connection, I mentioned about the good work that my Austin center had done in the taxpayer services area. I'm told by the staff that the Austin Service Center shows an inventory of 10,000 letters over 30 days old from taxpayers who have received underreported notices.

And I ask you why aren't those letters being handled more quickly? Have there been staffing reductions in that area, and why?

Can you comment, any of you?

Mr. BRENNAN. Yes. If I understood your question, it would be in the compliance center. And there have been budget cuts there.

I am not aware of the 10,000. I'll look at it. But I would assume that the cuts that we made have caused it.

Chairman PICKLE. But, sir, you've got 10,000 letters, an inventory of 10,000 in this underreporter area. I have looked at our charts on the other districts in that same area, and they don't have any backlog. They are all at zero except the Austin center.

Why would that be? Did they cut the program out entirely, just stop it?

Mr. BRENNAN. No. I don't know the answer. I will provide you with a report on that, sir.

[The following was subsequently received:]

Reports from Austin indicate the following volumes of overaged responses to TY 1987 underreporter notices (volume is decreasing): Overage volume per February 2, 1990 report, 13,813; March 16, 1990 report, 8,026; and March 30, 1990 report, 6,753.

Austin informed us that overaged TY 1987 responses occurred because of budget/staff cuts, forcing management to prioritize work in the following priority:

(1) Because of potential statute concerns, complete the TY 1986 program;

(2) Complete TY 1987 High Underreporter mailouts (potential fraud cases); cases must be worked as early in the program as possible to give districts ample time to properly develop the cases for fraud referral; and

(3) Work TY 1987 responses. During this period, Austin did not stop working responses altogether, but provided reduced response coverage.

As of mid-February 1990, Austin had diverted staffing (30–40) from the screening phase and was providing refresher response training as a means to reduce overage response inventories. Also, overtime has been authorized. Austin hopes to reduce overage inventories to below 1,000 responses by April 20, 1990.

Chairman PICKLE. Well, now, yesterday I had my district director here from Austin, and I don't know whether he's in the audience. But if he's here and he's hearing the question, I want you to tell me why you have 10,000 letters there. And so if my director is out there, I will expect a response and that a copy be sent to your national office so you'll know too.

Mr. BRENNAN. Yes, sir.

Chairman PICKLE. You don't have an answer for him.

Mr. BRENNAN. No, sir.

Mr. MURPHY. Mr. Chairman, if you met with the district director, is the information you are talking about at the compliance center?

Chairman PICKLE. At the Austin Service Center, yes.

Mr. MURPHY. At the service center so we can look into that.

Chairman PICKLE. Well, Mr. Orosco, if you're out there, you pass that on to your service center man.

Mr. Commissioner, we are going to go on. We have some testimony to receive now from the GAO.

And I thank you very much, and all your staff, for being with us this morning.

Let me say again to you that we will have another hearing on the IRS either just before or right after the close of the filing season. And we'll have others during the year, particularly if we go further into this computer modernization program. So, we will be inviting you back up here again soon.

Mr. GOLDBERG. We will look forward to it.

Chairman PICKLE. Thank you very much for your testimony.

Mr. ANTHONY. Mr. Chairman, could I just close with making one request?

Chairman PICKLE. Yes, Mr. Anthony.

Mr. ANTHONY. If, as a result of all the budget shakeups, you are paying rent on empty buildings that you can't get rehabbed, could you try to get that one resolved very quickly?

Mr. MURPHY. Mr. Anthony, that building is filled with asbestos, and there are many other problems where, even if the building was ready, we could not occupy it right now.

Mr. ANTHONY. Cancel your lease.

Mr. MURPHY. We have not canceled the lease.

Mr. ANTHONY. Well, cancel your lease. Don't pay somebody for a building you can't use.

Mr. GOLDBERG. Can we get that down as specific instructions, Mr. Anthony?

Mr. ANTHONY. If you've got a probable lawsuit, file a lawsuit.

Mr. GOLDBERG. Thank you very much.

Chairman PICKLE. Thank you very much, Commissioner.

Mr. GOLDBERG. Thank you.

[Questions and responses by IRS and additional correspondence follow:]

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April 26, 1990

The Honorable Fred T. Goldberg, Jr.
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Mr. Commissioner:

I appreciate your appearance as a witness at the Subcommittee on Oversight's hearing on the 1990 tax return filing season and the Administration's fiscal year 1991 budget proposals relating to the Internal Revenue Service. To complete our hearing record, I would appreciate receiving your responses to the following questions by May 18, 1990.

I. 1990 TAX FILING SEASON:

A. OVERVIEW OF THE FILING SEASON:

1. How many of the returns were filed in the 1990 filing season? How many returns have been processed thus far? What is the average length of time to process a return? What is the average refund amount? How does this compare with similar data for the 1989 and 1988 filing seasons?

2. How many taxpayers filed the Form 4868 requesting an automatic extension of the time to file? How does this compare with similar data for the 1989 and 1988 filing seasons?

3. The tax forms this year included a line for the Supplemental Medicare premium which was repealed by the Congress. Did taxpayers erroneously complete this line? Did taxpayers call the IRS for guidance on this issue or request information from your forms and publications distribution centers?

4. This year taxpayers claiming the child and dependent care credit needed to attach a form and provide the taxpayer identification number of the person providing care. Did taxpayers comply with this requirement? Did any problems develop, and, if so, how has the IRS responded to the problems?

5. How many returns were filed by taxpayers whose income level falls below the threshold requiring them to file, but who file anyway in order to receive a refund by reason of the earned income tax credit? How does this compare with data from the 1989 filing season? How many taxpayers, do you estimate, are eligible for the credit but fail to file a return? What type of program could be developed to make the earned income tax credit more accessible for those eligible who fail to file a return? Does the IRS have any plans for better dissemination of information concerning the utilization of the earned income tax credit, particularly for low-income families that are unfamiliar with the filing procedures for claiming the credit?

6. The IRS reported that the most frequent error this year by taxpayers was where taxpayers claim the earned income credit when not entitled to it. How often has this occurred and what has the IRS done to notify these taxpayers?

7. What were the top ten taxpayer errors during the filing season? How does this compare to errors during the 1989 and 1988 filing seasons?

8. What were the top ten IRS processing errors? What changes to our tax system would simplify tax return processing at the IRS (e.g., no longer reporting cents on returns)?

9. What problems have IRS's Taxpayer Ombudsman and Internal Audit identified during this filing season?

B. <u>IRS TELEPHONE ASSISTANCE PROGRAM (Accuracy and Availability):</u>

1. What was the overall accuracy rate for the telephone assistance program during the 1990 filing season nationwide and at each of the IRS telephone assistance call sites? How does this compare with the 1989 and 1988 filing seasons?

2. During the 1990 filing season, how many telephone assistance calls were answered? How many received a busy signal? How many telephone calls did the IRS expect to receive? What "level of service" was achieved overall and at each of the IRS telephone assistance call sites? What level of service was planned overall? When a taxpayer placed a call to the IRS this year, what was the likelihood the call would be answered on their first attempt? How do each of these answers compare with similar data for the 1989 and 1988 filing seasons?

3. How many telephone lines and telephone assistors were in place during the filing season? How does this compare with the 1989 and 1988 filing season levels?

4. What were the most frequent taxpayer questions?

5. Last year, the IRS conducted a "taxpayer service customer satisfaction survey" to measure taxpayer perceptions about the quality of service they were receiving. What did the IRS do this year in light of taxpayer comments in the survey?

6. What was the accuracy rate with the EXPERT system at the Boston call site? What problems have you had with EXPERT? What changes do you expect to make to EXPERT? What types of taxpayer inquiries can the EXPERT system handle? What types can the system not handle? Are there any plans to implement EXPERT nationwide?

C. FORMS AND PUBLICATIONS:

1. Which forms and instructions needed for the filing season were backordered at any point during the filing season, and how many backorders were awaiting shipment?

2. Were forms and publications backordered because of cost cutting measures, i.e., the IRS did not print an adequate supply in order to save money?

3. How did the demand for forms and publications compare with IRS's expectations?

4. Which changes in the 1989 tax forms were effective in eliminating or reducing errors during this filing season? What improvements, if any, will the IRS make to the 1990 tax forms?

D. IRS SERVICE CENTER INVENTORIES:

1. What were the inventory levels for unpostables, adjustments/correspondence, and unidentified remittances, during the month of April at each of the service centers? How many cases in each of these inventories are over 45 days old? How do the inventory levels and age compare with the same data in April of 1989 and 1988? Please provide the reasons for any significant increases in 1990.

2. As mentioned during the Subcommittee's hearing, the Austin Service Center reported an inventory of 10,000 letters over

30-days old from taxpayers who received underreporter notices. Why aren't these letters being handled more quickly? What have been the staffing reductions in that program overall and at the Austin Service Center during fiscal year 1990?

3. The inventory of unpostables in Memphis Service Center has not declined as much as the unpostable inventories at other service centers, despite the use of a direct link to Martinsburg to resolve unpostables (On-Line Entity). Has OLE been a success? What are its uses? What plans do you have to use OLE at other service centers? Do you plan to make use of OLE during the processing of returns, so that unpostables are caught early on at the service centers?

E. ELECTRONIC FILING:

1. How many tax returns were filed electronically? How does this compare with 1989? What problems have you experienced with the electronic filing system?

2. What are the advantages to the IRS when a taxpayer files electronically?

3. If a preparer wants to file electronically, how much, on average, does it cost him to purchase the equipment and software necessary to do so? How much, on average, do preparers and transmitters charge taxpayers to file their returns electronically? Does the IRS regulate this fee?

4. What plans are there to expand electronic filing to include (1) other types of returns and (2) taxpayers with tax liabilities?

5. Does filing electronically--with no paper trail that can be examined--make it easier to create fraudulent refund schemes? Have you discovered any fraudulent refund schemes involving electronically filed returns?

6. Do you foresee the day when the system is "paperless", when virtually all returns will be filed electronically? When?

F. COMPUTER PROBLEMS:

1. Why was there a two-week delay for certain taxpayers who filed with the Cincinnati Service Center? Where were the tapes for the two weeks that they were "lost"?

2. Is the system of transmitting tax information secure? What controls are there to assure that tapes sent from the service centers to Martinsburg are actually received?

3. Are the service centers able to electronically transmit data directly to Martinsburg? Will this system of transmitting data by tape be replaced when the IRS modernizes its computer system?

II. ADMINISTRATION'S FISCAL YEAR 1991 BUDGET PROPOSALS FOR IRS:

A. OVERVIEW OF THE BUDGET:

1. IRS originally asked the Administration for $6.37 billion and 119,841 positions. The Administration added $191 million for a new initiative. In total, IRS's request was $400 million over the Administration's request to Congress. What additional programs could have been implemented under your budget request? What additional programs could have been implemented if the Administration had approved the full amount of your fiscal year 1991 appeal?

2. If IRS received $100 million more than the Administration's budget request, to where would it be allocated?

3. The budget shows savings in fiscal year 1991 of 157 positions from A-76 contracts. This is OMB's program to have agencies save money by contracting out to private parties certain government functions. Has IRS realized any reduction in staffing because of A-76 contracts? What positions have been contracted out? What positions have been studied to determine the feasibility of outside contracting and what were the findings? Has IRS determined what IRS functions will be contracted out in fiscal year 1991 and how this program will work?

4. In fiscal years 1990 and 1989, the IRS was supposed to eliminate 2,000 positions as part of A-76 contracting out. How many of those functions were contracted out? How many more positions did the IRS need to fund than the 1990 and 1989 budgets provided for because of unrealized A-76 savings?

5. In fiscal year 1988, the IRS requested more staffing and funding than that which is included in the Administration's fiscal year 1991 budget request. Has the IRS fallen three years behind in staffing and programs?

6. Please provide a budget chronology for fiscal year 1981 through fiscal year 1991 of staffing and funding levels requested by the IRS to Treasury, Treasury to the Office of Management and Budget (OMB), OMB to Congress, final Congressional action, and actual level realized.

7. Please provide a chronology of IRS staffing levels from fiscal year 1981 through fiscal year 1991 estimates in the following areas: revenue agents, revenue officers, special agents, tax examiners, tax auditors, taxpayer service representatives, and taxpayer service specialists (include a description of the position and current salary levels).

8. Please provide the staffing and funding levels for each IRS program from fiscal year 1978 through fiscal year 1991 estimates.

9. Please provide a comparison of IRS key workload indicators from fiscal year 1981 through fiscal year 1991 estimates, to include tax returns filed, taxpayers assisted, tele-tax contacts, level of telephone service, examination coverage rates, delinquent accounts closed, delinquent returns secured, tax fraud investigations, employee plan determination letters and examinations, exempt organization determination letters and examinations, and accounts receivable inventory data.

B. <u>REVENUE INITIATIVES INCLUDED IN THE BUDGET:</u>

1. The Administration's budget shows a $2.5 billion increase in revenue collected by reallocating existing resources into areas which have a higher revenue yield. Please provide a description of the areas where staff and funding will be taken from and the areas to which staff and funding will be added and the revenue yield for each. Also provide a comparison of the staffing and funding levels in the affected areas over the past three years.

2. The Administration's budget also provides increased funding for tax law enforcement. Please provide a description of each of the areas covered by the proposal, the staffing and funding levels for each, the revenue yield, and the reason increased enforcement is necessary in that area.

3. The Administration's budget includes a revenue initiative for enhanced enforcement of certain small pension plans. The two tax issues involved relate to interest rate and age actuarial assumptions. Please provide a description of the scope of

the initiative, reason(s) for the initiative, the types of taxpayers and plans involved, and several factual examples illustrating the problem.

4. The fiscal year 1991 tax shelter initiative would accelerate the examination and closure of key tax shelter cases. By the end of March, the IRS was to have identified 35 of the largest key cases. How did IRS develop an initiative in this area without already identifying key cases? How many tax shelter cases did the IRS project would be closed under this initiative? Describe the types of tax shelters and issues involved in these cases.

5. The IRS has been targeting closure of tax shelter cases for years, therefore would it be fair to assume the current inventory is comprised of the most difficult cases to close? What makes the IRS think these taxpayers will settle-up now if they rejected previous attempts to resolve their disputes?

6. The IRS plans to devote additional resources to the examination of excise tax returns. What are the areas of excise tax noncompliance that the IRS will target in fiscal year 1991?

C. BUDGET PROPOSALS FOR IRS FUNCTIONS:

Taxpayer Service

1. Last fall, during the fiscal year 1991 budget discussions, the IRS indicated opposition to the Administration's plan to include revenue in fiscal year 1992 related to the charging of a user fee to taxpayers requesting assistance from the IRS on the telephone. A November 1989 Treasury memo to OMB noted that "Treasury will continue to work with vendors" to develop a program for the taxpayer service telephone user fee. Is the Administration still thinking of charging taxpayers for telephone assistance when there is a one-in-four chance they'll get a wrong answer? Does the "other user fee" category of the Administration's budget include revenue from the telephone user fee in fiscal year 1992?

2. Taxpayers are finding it more difficult to reach the IRS telephone assistance program this year. There are twice as many taxpayers who receive a busy signal as those who receive an assistor. The fiscal year 1990 budget states there would be an 85% level of service, and in fact IRS is showing only a 70% level. The fiscal year 1991 budget indicates there will

be an 80% level of service despite a decrease in the number of taxpayer assistance positions. How is that possible and what is the true level of service that can be expected under this budget?

3. What will be the accuracy rate if the Administration's fiscal year 1991 budget proposal is approved?

Examination

1. Compare the audit coverage for 1989, 1990, and the 1991 budget with a break down by income level for individuals and asset size for corporations.

2. The fiscal year 1991 may fall below one-percent. Is that acceptable?

3. What is the impact of an audit rate of less than one percent on voluntary compliance? Please provide the voluntary compliance levels from fiscal year 1981 through fiscal year 1991 estimates. How much revenue is lost for each drop of one percent in the voluntary compliance level?

Collection

1. The proposed budget for Collection shows an increase of 1,356 positions and $119 million. Approximately 1,000 of these positions and $51 million will be devoted to an accounts receivable initiative. What are you going to do? What will the currently-not-collectable inventory and the accounts receivable inventory be at the end of fiscal year 1991 if this initiative is funded? What would these levels be if this initiative is not funded?

2. In 1986, the number of positions devoted to investigating delinquent returns was 10% higher than that which is proposed for fiscal year 1991 (from 3,678 in FY 1986 to 3,363 in FY 1991). Why is the IRS devoting fewer positions to the delinquent returns program?

3. The IRS budget increase for Collections staffing appears to fall short of the increases needed for two collections initiatives (1,000 positions are needed for a fiscal year 1991 initiative, and an additional 800 positions needed to complete a fiscal year 1990 initiative that has been delayed due to IRS budget shortfalls this year). By how much will

each affected collection programs be reduced in fiscal year 1991 from the current fiscal year 1990 levels?

Employee Plans and Exempt Organizations (EP/EO)

1. In fiscal year 1991, the IRS estimates that it will review 252,000 employee plan amendments, plan terminations, and new plan applications, as compared with 106,000 in fiscal year 1990. Further the budget shows an increase in the employee plan and exempt organization audit rates. Yet, the budget proposes to handle this extra work with a decrease in the number of positions. How is this possible?

2. Since the EP/EO staff decreases in fiscal year 1991, what current programs in the employee plan and exempt organization functions are being cutback in fiscal year 1991 in order to handle the increased workload?

3. Exactly what issues will EP/EO be focusing on and at what staff and funding levels?

4. Please provide the employee plan audit coverage and exempt organization audit coverage, according to plan or organization size, in fiscal years 1989, 1990, and 1991 estimates.

Tax Fraud and Financial Investigations

1. The IRS continues to drop the number of positions devoted to the General Enforcement Program (GEP) which is responsible for activity involving questionable refund schemes, offshore banking, and tax havens. At the same time the IRS is increasing the number of positions devoted to the Special Enforcement Program, which is responsible money laundering and narcotics traffickers. Has there been a shift in priorities at the IRS toward drug enforcement activity or is there a decrease in the activity targeted by the General Enforcement Program? What impact does GEP staffing have on overall compliance?

Appeals, Tax Litigation and Technical

1. The technical function at the IRS explains to taxpayers and IRS personnel the application and interpretation of our tax laws and, according to the budget, "facilitates taxpayer compliance". In 1989, there were 12,000 requests for assistance in the technical ending inventory. In fiscal year 1991, there will be three times that amount, 34,200 cases

pending in the technical ending inventory. Why is the technical inventory increasing? What advice do you give to IRS employees and taxpayers who are waiting for technical assistance?

Internal Audit

1. How has the creation of an Inspector General (IG) at the Department of Treasury affected the IRS's Internal Audit and Internal Security divisions? How much money did IRS transfer to Treasury to fund the IG in fiscal year 1990? How much is proposed for transfer in fiscal year 1991?

2. Will the IRS be funding the Internal Audit and Internal Security divisions in addition to transferring additional funds to Treasury for the Treasury IG?

3. Internal Audit will be completing 25% more cases (404 in total) in fiscal year 1991 than completed this year. Why are the number of cases increasing to such a large degree in one year?

Returns Processing

1. The budget proposes an additional 135 positions for returns processing in fiscal year 1991. Yet, the budget indicates that an additional 383 positions are needed for a revenue initiative and an additional 157 positions are needed to handle the processing and printing of millions more tax returns and supplemental documents. How will the IRS handle additional work for 540 positions by only adding 135 positions?

III. FISCAL YEAR 1990 BUDGETARY SHORTFALL:

1. What is IRS's most recent estimate of the fiscal year 1990 budgetary shortfall? What is IRS's most recent estimate of the revenue loss associated with the budgetary shortfall? What program adjustments has IRS made due to the shortfall in funding?

2. For which areas within the IRS has the two year hiring freeze caused fiscal year 1990 staffing levels to drop below fiscal year 1988 levels? How has the hiring freeze affected the ability of current IRS employees to move up within the Service? How has the freeze affected employee attrition?

3. Are the following examples of cutbacks in IRS operations and service accurate: examination staffing levels at service centers are only 65% of previous years; service centers can no longer work alternative minimum tax cases; self-employment taxes can not be examined even though they yield around $1,500 for less than an half hours work; the underreporter program has been cut this year (on top of last year's cut of 469 positions); IRS training programs no longer include a refresher course for tax examiners on recent tax law changes (training was also cut last year, so examiners may have gone two years without an update); cutbacks in travel have caused IRS district offices to select employee plans to examine based upon the location of the taxpayer (determined by the zip code) rather than the potential revenue yield; the IRS is paying rent for space on the West Coast that it cannot move into because the office cannot afford the cost of moving and hooking up the computers; the staff in the automated collection system has been cut; taxpayers are twice as likely to get a busy signal when calling the IRS for assistance than an answer; and, millions of affected taxpayers did not receive a supplemental mailing from IRS on the repeal of the Supplemental Medicare premium? Are these cutbacks due to budget shortfalls?

IV. TAX SYSTEM MODERNIZATION (TSM):

1. Is TSM a high priority with the IRS? When do you think that TSM will be completed? What will the total price be? Do you expect the master plan to be completed on time, in September of this year?

2. Will TSM be as dependent on paper documents as the present system is? What will replace paper? What is the status of the system ("input processing") which will convert paper documents to electronic images?

3. After implementation of TSM, will the IRS still ship tax information via computer tape to the Martinsburg Computing Center? Will computer systems the various IRS offices be able to communicate electronically with Martinsburg?

4. Your most recent analysis shows that the mainframe computer in the largest service centers should have enough capacity to support processing through 1992. During 1991, what are you going to do to ensure against capacity shortages and operational disruptions after 1992? Do you have a specific schedule with dates and milestones for implementing initiatives to ensure sufficient computer capacity?

5. If you experience delays with the TSM projects, how long do you believe the current systems will be able to support processing operations before they experience capacity or serious reliability problems?

As always, I appreciate your attention to this request. I look forward to working with you to ensure that the IRS receives the funding and staffing necessary to ensure effective and fair administration of our tax laws.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/sal

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

SEP 18 1990

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Ways and Means
Subcommittee on Oversight

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
House Committee on Ways and Means
1105 Longworth Building
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your letter of April 26, 1990 asking a number of questions to follow up on the Subcommittee's hearing on the 1990 tax return filing season and the Administration's fiscal year 1991 budget proposals relating to the Internal Revenue Service.

If your staff has any questions, please have them contact Rick Hinkemeyer, Acting Director of Legislative Affairs Division at 566-6070.

Best regards.

Sincerely,

Gayle G. Morin
Assistant to the Commissioner
(Legislative Affairs)

Enclosure

I. 1990 TAX FILING SEASON

A. Overview of the Filing Season:

1. How many of the returns were filed in the 1990 filing season? How many returns have been processed thus far? What is the average length of time to process a return? What is the average refund amount? How does this compare with similar data for the 1989 and 1988 filing seasons?

	1990	1989	1988
Returns filed thru April (In Thousands)	104,253	101,614	98,643
Returns processed thru April (In Thousands)	73,999	70,398	69,875
Average Refund Amount	$865	$843	$850

The average length of time to process a return through the pipeline and post to the Master File is 45 days. The average was the same for 1988 and 1989--about 45 days.

2. How many taxpayers filed the Form 4868 requesting an automatic extension of the time to file? How does this compare with similar data for the 1989 and 1988 filing seasons?

By 4/28/90, 3.2 million extensions (Forms 4868) had been received nationwide. For previous filing seasons, 3.8 million were received in 1989 and 4.1 million in 1988. The trend is a steady decline in the number of extensions being filed. The total extensions processed for 1989 were 5.3 million, and for 1988 were 5.5 million.

3. The tax forms this year included a line for the Supplemental Medicare premium which was repealed by the Congress. Did taxpayers erroneously complete this line? Did taxpayers call the IRS for guidance on this issue or request information from your forms and publications distribution centers?

Some taxpayers did make an entry on this line, requiring ERS correction. However, an insignificant number of returns were involved and they had a minimal impact on processing.

Taxpayers called for information on what to show on this line. Based on our limited random sampling of slightly over four million technical calls, a very small percentage (0.5867 percent) dealt with this issue.

We also experienced demand for the forms and publications which had been announced for implementation of the Supplemental Medicare premium. This demand came via phone calls, order blanks

and correspondence. We are unable to document the volume of this demand; however, we believe that the methods we employed to respond to it were effective. Callers requesting the items were immediately informed of the repeal of the law. A notice explaining the repeal of the law was prepare to respond to mailed-in-orders. This notice was also available for our field offices to order.

4. This year taxpayers claiming the child and dependent care credit needed to attach a form and provide the taxpayer identification number of the person providing care. Did taxpayers comply with this requirement? Did any problems develop, and, if so, how has the IRS responded to the problems?

The majority of taxpayers attempted to comply with the requirement, but it was apparent that many were confused about the specific information needed. For example, some taxpayers identified the "Provider" as the father of the child, since he provided the payment. Other taxpayers gave the state licensing number, instead of the federal EIN. Many did not give the same dollar amount of expenses in the Provider area as they claimed on the expenses line of the form. We issued interim instructions to deal with these problems.

5. How many returns were filed by taxpayers whose income levels fall below the threshold requiring them to file, but who file anyway in order to receive a refund by reason of the earned income tax credit? How does this compare with data from the 1989 filing season? How many taxpayers, do you estimate, are eligible for the credit but fail to file a return? What type of program could be developed to make the earned income tax credit more accessible for those eligible who fail to file a return? Does the IRS have any plans for better dissemination of information concerning the utilization of the earned income tax credit, particularly for low-income families that are unfamiliar with the filing procedures for claiming the credit?

Sufficient data from the recent 1990 filing season are not yet available to address this question for tax year 1989 returns. The available Statistics of Income (SOI) Division information for tax year 1986 indicates that about 4.6 million returns were filed with a portion of their earned income credit refundable. This 4.6 million includes taxpayers with no requirement to file; those required to file but with no tax liability; and those required to file but whose earned income credit exceeded their tax liability. This respective SOI figure for tax year 1987 is 6.5 million returns. The preliminary SOI estimate for tax year 1988 is 7.8 million.

In the fall of 1989 we estimated that approximately 800,000 taxpayers would be eligible for the earned income credit in tax year 1989 but would not file to claim it. The data from the recent 1990 filing season are not yet available to evaluate the

accuracy of this prior estimate.

Each year, the IRS employs a wide variety of means to disseminate information on the earned income credit. For example, in addition to information in the tax packages and information publications, we include articles on EIC in our Tax Supplements and Clipsheets (including our Spanish-language clipsheet) which are camera-ready collections of tax information articles for use by newspapers, company newsletters and employee publications, and other print media. We provide local public affairs officers with modules of news releases, question and answer columns, and fact sheets on EIC dissemination to local print media, and posters to be displayed in the workplace and public assistance offices.

We also disseminate information through the electronic media in formats such as PBS and Spanish TV tax clinics, cable TV call-in shows, radio vignettes (also in Spanish), and instructional video and audio tapes. EIC is included in most programs whose format allows for a variety of subjects to be covered.

Of course, EIC information is given to taxpayers who call in to our toll-free information lines and ask questions on EIC, request the free publication, or call Tele-Tax (pre-recorded message is available in both English and Spanish). Also, volunteers who staff our VITA and TCE have training on EIC to enable them to discern and help qualifying taxpayers.

To reach potential EIC recipients through the workplace, we send employers business and employment tax publications and tax forms packages with EIC information and Notice 797, which is to be given to their employees.

Outside of the workplace and traditional information media, we have worked in partnership with the Center on Budget and Policy Priorities since January 1989 to publicize EIC. In the last two years, through this joint effort, the Center, local non-profit organizations, state agencies, and IRS personnel have publicized EIC through church bulletins, soup kitchens, tax preparation and news media events, and other individual and joint projects.

6. The IRS reported that the most frequent error this year by taxpayers was where taxpayers claimed the earned income credit when not entitled to it. How often has this occurred and what has the IRS done to notify these taxpayers?

For the period 1-1-90 to 4-21-90, we issued 308,748 notice codes telling taxpayers that they did not qualify for the Earned Income Credit which they claimed on their returns. We also issued 377,341 notice codes telling taxpayers that we adjusted the Earned Income Credit claimed on their returns. In addition, we figured Earned Income Credit for taxpayers who did not claim it 307,901 times. The total number of taxpayers who were detected

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making an error on the computation of EIC was 993,990.

7. What were the top ten taxpayer errors during the filing season? How does this compare to errors during the 1989 and 1988 filing seasons?

Filing Period 1988 as of 04/30/88	# of Returns With Errors	Type of Form
An error was made on the return because the amount claimed as the estimated tax payment or credit was incorrect:	455,070	1040
An error was made on the return because the earned income credit was figured or entered incorrectly:	337,302	1040A
An error was made in entering the amount of the standard deduction when figuring taxable income:	212,684	1040A
An error was made on the return because the taxpayer did not figure their earned income credit:	202,095	1040A
An error was made on the return because the taxpayer did not figure their earned income credit:	193,898	1040
An error was made on the return when the refund or the amount owed was figured:	161,064	1040
An error was made on the return when the refund or the amount owed was figured:	155,881	1040A
An error was made on Sch. A when the miscellaneous expenses were figured:	153,249	1040
An error was made on the return because the earned income credit shown on the return cannot be allowed because the taxpayer did not qualify for it:	150,063	1040A
An error was made on the return when the refund or the amount owed was figured:	146,039	1040EZ

Filing Period 1989 as of 04/29/89	# of Returns With Errors	Type of Form
An error was made on the return because the amount claimed as the estimated tax payment or credit is incorrect:	378,251	1040
An error was made in entering the amount of the standard deduction when figuring taxable income:	360,731	1040A
An error was made on the return because the earned income credit shown on the return cannot be allowed because the taxpayer did not qualify for it:	283,420	1040A
An error was made on the return because the earned income credit was figured or entered incorrectly:	252,697	1040A
An error was made on the return because the taxpayer did not figure the earned income credit:	207,773	1040A
An error was made on the return because the taxpayer did not figure the earned income credit:	199,560	1040
An error was made on the return when the refund or the amount owed was figured:	153,958	1040A
An error was made on the return when the refund or the amount owed was figured:	141,485	1040
An error was made on the return when the refund or the amount owed was figured:	121,163	1040EZ
An error was made on the return because the earned income credit was figured or entered incorrectly:	120,222	1040

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Filing Period 1990 as of 04/28/90	# of Returns With Errors	Type of Form
An error was made on the return because the amount claimed as the estimated tax payment or credit is incorrect:	392,700	1040
An error was made on the return because the earned income credit was figured or entered incorrectly:	246,445	1040A
An error was made on the return because the earned income credit shown on the return cannot be allowed because the taxpayer did not qualify for it:	245,027	1040A
An error was made in failing to enter, or in entering the wrong amount for the standard deduction when figuring the taxable income:	204,168	1040A
An error was made on the return because the taxpayer did not figure the earned income credit:	157,424	1040A
An error was made on the return when the refund or the amount owed was figured:	154,079	1040A
An error was made on the return because the taxpayer did not figure the earned income credit:	153,447	1040
An error was made on the return when the refund or the amount owed was figured:	146,846	1040
An error was made on the return because the earned income credit was figured or entered incorrectly:	130,896	1040
An error was made on the return when the refund or the amount owed was figured:	119,413	1040EZ

8. What were the top ten IRS processing errors? What changes to our tax system would simplify tax return processing at the IRS (e.g., no longer reporting cents on returns)?

The attached chart shows the top ten processing errors for the week ending 5-2-90 and for the entire filing period from 1-24-90 to 5-2-90. (See Attachment A.)

As for changes to the tax system, the IRS continues to work with the Department of Treasury on ways to simplify the tax laws. Specifically, we believe that simplification of the rules for claiming both Earned Income Credit and Child Care Credit would benefit both the taxpayer and the Service.

9. What problems have IRS's Taxpayer Ombudsman and Internal Audit identified during this filing season?

The Office of the Taxpayer Ombudsman reports that the 1990 filing season went well. Some problems which were identified are:

Some practitioners had to reorder forms and publications that had not been received. Although we do not know how many tax practitioners placed reorders, many who did may have reordered items before late forms and publications became available.

There were systemic problems with electronically filed returns with requests for direct deposit refunds. The Ombudsman has recommended that the revenue procedure for electronic filing (Publication 1345) be reworded to reduce future problems with these accounts.

A discrepancy in the explanation of the standard meal allowance between Publication 17 and current revenue procedures was discovered. Revenue Procedure 90-15 was issued to correct this discrepancy.

Incorrectly addressed envelopes were mailed out in some Form 1040ES packages and in some 1989 tax packages. Some taxpayers in the Southest Region received envelopes for returning Form 1040ES vouchers to Pittsburgh instead of Saint Louis due to a contracting error. A limited number of tax packages mailed to elderly taxpayers also contained envelopes with an incorrect address due to a contracting error.

Our current internal audit on the Processing of 1989 Individual Tax Returns has not identified any major problems. We are also conducting reviews of the Electronic Filing System and Magnetic Media Shipments between the Martinsburg Computing Center and the 10 service centers but have not finalized these reviews at this time.

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B. IRS TELEPHONE ASSISTANCE PROGRAM (Accuracy and Availability):

1. What was the overall accuracy rate for the telephone assistance program during the 1990 filing season nationwide and at each of the IRS telephone assistance call sites? How does this compare with the 1989 and 1988 filing seasons?

PERCENT CORRECT ACCURACY

	1988 (1)	1989 (2)	1990 (3)
SOUTHEAST REGION	75.3	62.7	79.0
Atlanta	70.5	57.2	75.2
Jacksonville	80.1	66.0	82.3
Nashville	75.7	67.4	79.2
MIDWEST REGION	74.7	63.7	79.6
Chicago	70.9	58.2	72.2
Des Moines	76.5	69.8	83.1
Omaha	78.9	73.0	84.6
Milwaukee	78.7	65.0	87.3
St. Louis	73.8	62.5	82.8
St. Paul	76.5	69.1	82.0
CENTRAL REGION	75.7	67.7	77.4
Cincinnati	73.6	65.6	74.6
Cleveland	73.2	69.8	80.4
Detroit	78.3	65.2	77.1
Indianapolis	77.5	70.6	78.6
SOUTHWEST REGION	71.4	62.7	78.2
Dallas	71.7	59.6	82.8
Denver	71.4	64.6	76.7
Houston	69.8	65.5	74.7
Phoenix	73.9	62.0	73.0

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PERCENT CORRECT ACCURACY

	1988	1989	1990
NORTH ATLANTIC	69.0	59.2	76.3
Boston	70.0	58.6	79.7
Brooklyn	62.4	52.1	69.0
Buffalo	78.0	67.7	78.7
MID ATLANTIC REGION	71.8	61.4	75.8
Baltimore	73.8	64.1	78.6
Newark	67.8	52.0	72.8
Philadelphia	68.5	54.9	68.1
Pittsburgh	76.7	72.6	81.3
Richmond	72.3	61.1	77.3
WESTERN REGION	69.9	62.6	73.6
El Monte	66.0	56.0	67.7
Portland	79.6	71.3	73.2
Oakland	65.3	65.1	75.5
Seattle	81.5	67.5	78.8
NATIONAL	72.4	62.8	77.2

(1) These are the cumulative figures through April 23, 1988.

(2) These are the final level estimates (cumulative) for percent correct through April 22, 1989.

(3) These are the cumulative figures from February 5 to April 21, 1990 for percent correct.

2. During the 1990 filing season, how many telephone assistance calls were answered? How many received a busy signal? How many telephone calls did the IRS expect to receive? What "level of service" was achieved overall and at each of the IRS telephone assistance call sites? What level of service was planned overall? When a taxpayer placed a call to the IRS this year, what was the likelihood the call would be answered on the first attempt? How do each of these answers compare with similar data for the 1989 and 1988 filing seasons?

1990

Calls answered - 17,450,747
Busy signals - 32,647,825
Calls expected - 23,499,191 (Estimated demand*)
Level of service (overall) - 71.2
Planned level of service - 75.0

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1989

Calls answered - 19,555,772
Busy signals - 12,726,898
Calls expected - 21,844,965 (Estimated demand*)
Level of service (overall) - 82.7
Planned level of service - 85.0

1988

Calls answered - 20,049,932
Busy signals - 10,895,931
Calls expected - 25,281,969 (Estimated demand*)
Level of service (overall) - 84.7
Planned level of service - 85.0

Filing period 1990: First attempt accessibility 58.3%. (The accessibility survey was not in existence until after the 1989 filing season.)

* The estimate made annually is the demand, number of taxpayers expected, not an estimate of the number of calls the demand will generate.

Level of Service

	1988	1989	1990
Nationwide	84.7	82.7	71.2
Atlanta	80.2	76.6	68.9
Jacksonville	83.2	84.3	66.8
Nashville	79.5	77.2	71.5
Chicago	88.4	80.1	72.1
Des Moines	85.3	83.6	69.7
Milwaukee	82.7	83.8	69.6
Omaha	86.2	84.7	73.5
St. Louis	83.4	81.4	69.6
St. Paul	87.4	84.3	72.4
Cincinnati	85.1	83.9	73.4
Cleveland	85.5	82.8	71.0
Detroit	85.9	85.8	70.6
Indianapolis	83.1	85.4	71.1
Houston	86.0	85.7	72.5
Dallas	86.9	84.1	75.6
Denver	87.1	86.0	75.3
Phoenix	86.4	85.4	74.6

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Level of Service

	1988	1989	1990
Boston	85.8	85.8	69.6
Brooklyn	86.4	84.7	73.7
Buffalo	85.5	81.9	74.6
Baltimore	88.4	81.7	72.9
Newark	85.6	84.6	75.8
Philadelphia	88.0	77.6	66.4
Pittsburgh	87.1	85.7	69.3
Richmond	86.4	80.4	68.6
Anchorage	85.8	83.7	69.2
Honolulu	86.5	83.9	71.1
Portland	84.8	82.8	70.8
Seattle	85.3	84.8	71.6
Los Angeles	82.8	84.4	70.1
San Francisco	81.4	81.4	71.1
Puerto Rico	88.0	90.9	76.0

3. How many telephone lines and telephone assistors were in place during the filing season? How does this compare with the 1989 and 1988 filing season levels?

	1990	1989	1988
Telephone lines	4,411	4,622	4,359
Telephone assistors	4,732	5,095	4,403

4. What were the most frequent taxpayer questions?

The quality review sampling indicates the top 5 technical questions of the 1990 Filing Season concerned:

1) Filing Requirements - 1040 series
2) Determining Dependents
3) Capital Gain/Loss - Sch. D and Form 4798
4) Sole Proprietorship - Sch. C
5) Estimated Taxes - Form 1040-ES

Also, the early results of Tele-Tax usage indicate the Electronic Filing topic was the most frequently requested tape.

5. Last year, the IRS conducted a "taxpayer service customer satisfaction survey" to measure taxpayer perceptions about the quality of service they were receiving. What did the IRS do this year in light of taxpayer comments in the survey?

The Service has established a Correspondence task force composed

of personnel from IRS regions and national office which is studying our correspondence program to improve the quality of our responses and to establish consistent and appropriate timeliness criteria. This task force was established as a result of last year's survey.

6. What was the accuracy rate with the EXPERT system at the Boston call site? What problems have you had with EXPERT? What changes do you expect to make to EXPERT? What types of taxpayer inquiries can the EXPERT system handle? What types can the system not handle? Are there any plans to implement EXPERT nationwide?

The Boston call site achieved an accuracy rate of 79.7% for the 1990 filing season. This was an improvement over the 1989 accuracy rate of 58.7%. The major problem experienced with the Expert system was due to the constant changes and enhancements of the knowledge bases throughout the filing period. We plan to expand Expert system to a limited number of sites, improve existing knowledge bases, and create new knowledge bases for the next filing season. Expert system can handle the majority of technical and procedural inquiries. It is not intended to handle account inquiries at the present time. We do anticipate implementing the Expert system on a limited basis for the 1991 filing season and anticipate phasing in other call sites over the next three years.

C. <u>FORMS AND PUBLICATIONS</u>:

1. Which forms and instructions needed for the filing season were backordered at any point during the filing season, and how many backorders were awaiting shipment?

ITEM	TITLE	BACKORDERS
F W-2 (89)	Wage and Tax Statement	5,215
F W-3 (89)	Transmittal of Income & Tax Statements	75,299
F 706 Sch S	Increased Estate Tax & Excess Retirement Accumulation	67,038
F 720	Quarterly Federal Excise Tax Return	60,916
F 911	Application for Taxpayer Assistance Order to Relieve Hardship	788
F 990	Return of Organizations Exempt from Tax Under Sec 501(C)	104,367
I 990	Instructions for Form 990	105,456
F 990-EZ	Short Form Return of Organizations Exempt From Income Tax	1,772
I 990-EZ	Instructions for Form 990-EZ	1,916
F 990-PF	Return of Private Foundation or Section 4947(a)(1) Trusts Treated as a Private Foundation	5,912
I 990-PF	Instructions for Form 990-PF	4,713
I 1040-C	Instructions for Form 1040-C	2,797
I 1040-X	Instructions for Form 1040-X	5,010

F 1042-S	Income Subject to Withholding Under Chapter 3, Internal Revenue Code	4,444
F 1120-F	U.S. Income Tax Return of a Foreign Corporation	98
I 1120-F	Instructions for Form 1120-F	445
I 1120-FSC	Instructions for Form 1120-FSC	168
F 1120-IC DISC	Interest Charge Domestic International Sales Corporation Return	206
I 1120-L	Instructions for Form 1120-L	37
F 4972	Special 10-Year Averaging Method	34,517
F 5500	Annual Return/Report of Employee Benefit Plan (100 or more participants)	78,509
I 5500	Instructions for Form 5500	75,547
F 5500-C/R	Annual Return/Report of Employee Benefit Plan (fewer than 100 participants)	87,404
I 5500-C/R	Instructions for Form 5500-C/R	84,908
I 6765	Instructions for Form 6765	755
F 8283	Non-Cash Charitable Contribution	7,224
I 8283	Instructions for Form 8283	14,481
F 8453	U.S. Individual Income Tax Declaration for Electronic Filing	1,642
F 8804	Partnership's U.S. Source Income Subject to Section 1446 Withholding	1,805
F 8810	Corporate Activity Lost & Credit Limitations	2,545
F 8818	Redemption of College Savings Bonds Issued After 1989	948
F 9041	Application for Electronic/Magnetic Tape Filing for Forms 1041, 1065, 5500-C/R	51,853
K X Vol II	Information Copies of Tax Forms	125,685
P 1	Your Rights as a Taxpayer	13,454
P 514	Foreign Tax Credit for U.S. Citizens and Resident Aliens	14,394
P 519	U.S. Tax Guide for Aliens	12,493
P 553	Highlights of 1989 Tax Law Changes	117,372
P 554	Tax Information for Older Americans	8,620
P 557	Tax Exempt Status for Your Organization	17,678
P 559	Tax Information for Survivors, Executors, and Administrators	108,985
P 560	Self-Employment Retirement Plans	112,330
P 571	Tax Shelter Annuity Programs for Employers, Public Schools and Certain Tax-Exempt Organizations	9,487
P 575	Pension and Annuity Income	172,986
P 586-A	The Collection Process (Income Tax Accounts)	998
P 908	Bankruptcy	68,166
P 939	Pension General Rule (Nonsimplified Method)	13,146
P 1194	A Selection of IRS Tax Information Publications	167

2. Were forms and publications backordered because of cost cutting measures, i.e., the IRS did not print an adequate supply in order to save money?

No, while we did reduce the print quantities for a number of tax year 89 forms based on the year 88 end-of-year surpluses, we experienced very few stock outages during the filing season. We briefly (less than one week) were out of stock on 1989 Form W-2, an item for which demand is very difficult to predict. The vast majority of backorders were attributable to taxpayer and practitioner demand preceding initial receipt of the forms at the distribution sites.

3. How did the demand for forms and publications compare with IRS's expectations?

Demand was very close to expectations. Our requirements projections for individual forms and publications were by-and-large quite accurate (i.e. a small number of reprints have been required and surplus quantities are expected to be small). Order volumes were projected to be identical to the previous year, which has proven to be a correct assumption because actual volumes are running just 1% below last year's cumulative total for a comparable period.

4. Which changes in the 1989 tax forms were effective in eliminating or reducing errors during this filing season? What improvements, if any, will the IRS make to the 1990 tax forms?

From the 1989 processing year (1988 returns) to the 1990 processing year (1989 returns, for returns processed through 4/25/90), the percentage of returns with taxpayer errors declined. Following are some of the changes we made to the 1989 tax forms that helped accomplish this result:

a. We added a second name line to the Form 1040 and Form 1040A name and address section to reduce errors by taxpayers filing joint returns in entering the second name. The addition of a second name line for spouses has allowed the IRS to identify proper last names and process the returns more efficiently. In the past, when a husband and wife used different last names it was difficult to determine the primary taxpayer's last name (the name used to process the return). By having each spouse's name on a separate line, returns were input and processed with a higher degree of accuracy and less delay.

b. On Form 1040A, we rewrote and boldfaced the caption for line 16 (the standard deduction line), added the words "Be sure to enter your standard deduction here," and clarified the instructions. We revised the standard deduction charts in the Form 1040 instructions to specify the line to enter it on. We added a reference to the standard deduction in the "Avoid Common Mistakes" checklists.

The Standard Deduction chart in the Tax Package was moved to the top of the page to enable the taxpayer to easily determine the correct amount. Last year, the Additional Standard Deduction chart was at the top of the page and many taxpayers inadvertently selected the standard deduction for taxpayers who qualify for the "over 65" or "blind" additional amounts.

c. We have had problems with taxpayers not claiming the earned income credit, or claiming it when they were not entitled to it. We highlighted the EIC in the instruction booklets, including the fact that taxpayers should check to see if it applies to them. We also continued to call attention to the EIC directly on the adjusted gross income lines of Forms 1040 and 1040A. We added references to the EIC in the "Avoid Common Mistakes" section in the instructions to Forms 1040 and 1040A. To reduce errors resulting from taxpayers picking up incorrect amounts, we shaded every other horizontal group of rows in the EIC table in the Form 1040 and Form 1040A instruction booklets.

d. To help reduce math errors in computing taxable income and refunds, we included a reminder in the "Avoid Common Mistakes" checklists (for Forms 1040, 1040A, and 1040EZ) advising taxpayers to check their math.

e. To help taxpayers who were making the wrong entry for estimated tax payments, or who omitted the entry for the payments, we revised the Form 1040 instructions to clarify the amount to enter.

f. To help taxpayers who did not enter the total tax on Form 1040EZ, we revised the language on the total tax line (line 7) to highlight this issue.

g. The combination standard deduction and exemption amount on the Form 1040EZ made it easier for the taxpayer to complete the form accurately.

For the 1990 forms, we plan to make the following changes:

a. We will have a flow chart or a series of Q&As in the instructions for Forms 1040 and 1040A to help taxpayers see if they are eligible/ineligible for the earned income credit. We also rewrote the language on the adjusted gross income lines of these two forms that tells taxpayers to see if they might be eligible for the EIC.

b. We are adding a line to Forms 1040 and 1040A for taxpayers to report advance earned income credit payments. This has been a write-in item but only a small

percentage of persons who are receiving AEIC payments are reporting them.

c. We are adding a parenthetical to the "Single" filing status line of Forms 1040 and 1040A to advise taxpayers to see if they might be eligible for head of household filing status.

d. We are adding instructions for the "relationship" column in the dependent section of Forms 1040 and 1040A because taxpayers were often not entering "son," "daughter," etc.

e. On the income tax withholding line of Forms 1040 and 1040A we plan to boldface the text regarding withholding on Form(s) 1099, because some taxpayers were not checking the box on that line.

f. We are revising the instructions for lines 12, 18, and 19 (business income, rental, etc., income, and farm income, respectively) on Form 1040 to better inform taxpayers about the lines.

D. IRS SERVICE CENTER INVENTORIES:

1. What were the inventory levels for unpostables, adjustments/ correspondence, and unidentified remittances, during the month of April at each of the service centers? How many cases in each of these inventories are over 45 days old? How do the inventory levels and age compare with the same data in April of 1989 and 1988? Please provide the reasons for any significant increases in 1990.

The charts below show the comparison of total inventories and aged inventories in all ten service centers at the end of April for 1988 through 1990.

	Adjustments Inventory			Overage		
	4/90	4/89	4/88	4/90	4/89	4/88
ANSC	7,471	48,336	35,139	2,022	4,354	4,287
ATSC	54,787	37,834	47,547	5,036	3,630	6,951
AUSC	59,313	51,946	50,033	4,620	3,051	3,633
BSC	33,620	37,923	33,375	2,308	2,868	2,585
CSSC	58,411	59,637	36,923	2,387	2,381	1,308
FSC	41,547	55,467	58,256	2,320	4,571	7,918
KCSC	60,679	65,658	41,652	7,313	8,093	2,425
MSC	46,671	66,167	36,546	4,485	5,375	2,300
OSC	67,017	58,011	54,729	6,636	4,589	5,475
PSC	55,528	61,566	31,986	5,458	3,942	1,507
	524,421	542,545	426,186	42,585	42,854	38,389

Unpostables Inventory

	4/90	4/89	4/88
ANSC	35,686	44,499	80,342
ATSC	53,756	50,067	70,167
AUSC	53,092	54,581	56,638
BSC	53,866	77,749	65,961
CSC	27,843	35,730	29,830
FSC	36,013	49,790	97,081
KCSC	34,764	46,258	43,090
MSC	41,964	59,043	57,657
OSC	37,647	32,364	39,864
PSC	45,885	75,360	50,813
	420,516	525,441	591,443

Overage

	4/90	4/89	4/88
ANSC	1,353	6,092	5,660
ATSC	3,710	4,402	6,253
AUSC	2,109	4,595	5,259
BSC	1,428	2,053	2,735
CSC	1,245	1,401	903
FSC	1,207	1,999	7,544
KCSC	2,098	3,331	1,964
MSC	4,596	6,016	3,126
OSC	828	690	908
PSC	3,669	8,910	6,174
	22,243	39,489	40,526

Unidentified Remittance Inventory

	4/90	4/89	4/88
ANSC	1,041	1,714	2,715
ATSC	1,500	1,534	2,567
AUSC	874	593	835
BSC	1,480	1,971	2,421
CSC	1,045	993	1,613
FSC	2,444	3,128	2,252
KCSC	1,521	1,069	2,638
MSC	1,435	1,210	1,271
OSC	1,128	740	651
PSC	1,745	1,082	1,507
	14,213	14,034	18,470

Overage

Overage is not tracked

The only significant increase in inventory is at the Ogden Service Center, with a 16.3% increase. However, they have also realized a 9.1% increase in unpostable receipts, making the rise in inventory less significant. This increase may be attributable to the number of electronically filed returns being filed in Ogden. In addition, the unpostable staff in Ogden has been reduced since 1989. Management has informed us that this reduction in staff will not adversely affect the center's ability to timely process their workload.

Ogden is also the only center with a significant increase in aged cases. However, the percentage of aged cases to overall inventory is only 2%, a fact that reduces the significance of the increase.

2. As mentioned during the Subcommittee's hearing, the Austin Service Center reported an inventory of 10,000 letters over 30-days old from taxpayers who received underreporter notices. Why aren't these letters being handled more quickly? What have been the staffing reductions in that program overall and at the Austin Service Center during Fiscal Year 1990?

The Austin Compliance Center had to prioritize the workload in the Underreporter Branch over the past few months as follows:

1) Complete their Tax Year 1986 program,
2) Complete their CP-2501 mailouts, and
3) Work the responses to their Tax Year 1987 mailouts.

National Office Underreporter has been in close contact with the Southwest Region as a result of monitoring MISTLE (Management Information System for Top Level Executives) data which gives a weekly status of the various IRS service center programs. Due to budgetary constraints, the volume of underreporter cases over 30 days old in Austin was over 10,000 during January and February 1990. However, Austin was able to steadily decrease this inventory until it was zero by May 4, 1990.

For Fiscal Year 1990, reductions were scheduled to be taken during the Tax Year 1988 Program, beginning in July 1990. These reductions included 28 staff years for Austin, with a nationwide reduction of 300 staff years. Although the inventories were originally scheduled to be reduced, the Service Centers were recently instructed to reinstate their original Tax Year 1988 volumes, using savings in other areas to offset the staff year reductions. Southwest Region has indicated that this will present no problem at either the Ogden or Austin Center. The Program will include 9.2 million discrepant returns to be resolved compared to 6.2 million for the previous tax year program, which was reduced by budget cuts in FY 1989.

3. The inventory of unpostables in Memphis Service Center has not declined as much as the unpostable inventories at other service centers, despite the use of a direct link to Martinsburg to resolve unpostables (On-Line Entity). Has OLE been a success? What are its uses? What plans do you have to use OLE at other service centers? Do you plan to make use of OLE during the processing of returns, so that unpostables are caught early on at the service centers?

As of the end of April, Memphis Service Center has had the third best decline in unpostables. In July, 1989, Employee Plans Master File (EPMF) processing was centralized to three service centers, including Memphis. Prior to that time, Memphis did not process EPMF. Thus, the Memphis unpostable inventory is inflated due to the transfer of Employee Plans processing from other service centers. Memphis's unpostable inventory as of April 27 includes 6,479 EPMF cases. If these cases were subtracted from the total inventory, Memphis would have the best decline in unpostables.

The On-Line Entity (OLE) System has been successful in reducing unpostables. Cases which are input using nine specific command codes through the Integrated Data Retrieval System (IDRS) have the name and Taxpayer Identification Number (TIN) validated prior

to posting at the master file. This has reduced the number of unpostables received through these inputs. The full potential of OLE, however, will not be realized until it is used in conjunction with the processing of returns.

We believe that OLE will be a huge success, It has two primary uses. First, it is a query system. OLE provides immediate access to name and address (i.e,, entity) information for all taxpayers to all 15,000 of IRS Integrated Data Retrieval System (IDRS) terminals across the nation. Second, it provides a validation process whereby we can check every document as it is input to ensure that the entity information is accurate.

The query capability is fully installed and operational at all of our Service Centers, Regional and District Offices, and Posts of Duty. We are currently satisfying 160,000 queries per day from IRS field office personnel. The average response time to deliver the information is two seconds. Previously, it took 24 to 72 hours to deliver information.

The validation process is still under development. We have a small part of the validation installed in all our Service Centers. This part is directed at one percent of the input transactions. For these transactions the entity related unpostables have been reduced 90 percent. These OLE validation checks have been in place at all Service Centers since July 1989. OLE validation checks will be expanded to other documents, starting with Federal Tax Deposits, in July 1990. Beginning in 1991 OLE will be used during the processing of returns.

E. ELECTRONIC FILING:

1. How many tax returns were filed electronically? How does this compare with 1989? What problems have you experienced with the Electronic Filing System?

As of May 3, 1990, there have been 4,189,243 individual electronically filed tax returns accepted by the Internal Revenue Service for Tax Year 1989.

As of May 15, 1989, there were 1,158,559 individual electronically filed tax returns accepted by the Internal Revenue Service for Tax Year 1988.

No significant difficulties have occurred thus far, during the 1990 Filing Season. We have more than doubled the official projections for electronically filed individual tax returns with minimal impact on system processing. The three service centers involved in electronic filing of individual returns are up-to-date with error resolution, unpostable corrections, and print requests.

2. What are the advantages to the IRS when a taxpayer files electronically?

There are many advantages to the Service, when a taxpayer files electronically. The most notable is service to the taxpayer. Accepted electronic returns have significantly fewer error or unpostable conditions, therefore, issuance of refunds to the taxpayer is typically less than three weeks as compared to six weeks for a paper-filed return.

A greater number of returns can be processed through the processing pipeline and posted to our central repository (master file) in a much shorter period of time. Again, this is because an electronic return is a cleaner return when the data enters the processing pipeline.

An electronically filed return is nearly a paperless process. Presently, the numerous forms and schedules that are typically filed in a paper return are non-existent in an electronic return.

With the increasing population and number of returns filed, and their complexity, additional staffing resources would otherwise be required to process these paper returns. Electronic filing will serve to control resource requirements of the Service today and in the future.

3. If a preparer wants to file electronically, how much, on average, does it cost him to purchase the equipment and software necessary to do so? How much, on average, do preparers and transmitters charge taxpayers to file their returns electronically? Does the IRS regulate this fee?

In the electronic filing process, there are two basic steps that a preparer must take 1) return preparation, and 2) return transmission. For an investment of less that $1000 in equipment and software, the preparer can develop returns ready for transmission to the IRS. Through the use of a service bureau or company in the telecommunications business, a preparer can have the returns sent to the IRS for a nominal charge.

The Service has not made a study of the average fee charged to a taxpayer for filing electronically. The IRS does not charge a fee for electronically filed returns, so the cost to the taxpayer is based on the practitioner's fee. The fee varies based on the involvement of the practitioner in the filing process. The taxpayer may prepare the return and ask only for it to be transmitted, or the taxpayer may have the return prepared, transmitted, and obtain a loan in anticipation of the refund. The charges for these two extremes, and variations, differ among practitioners. The only restriction the IRS places on the practitioner is that the fee be consistent for all taxpayers for the equivalent service provided, and that it not be based on the

amount of refund. There are preparers that do not charge for this service.

The Service does not regulate the fees charged by private businesses in the performance of their service to the public in any way, including the preparation of tax returns.

4. What plans are there to expand electronic filing to include (1) other types of returns and (2) taxpayers with tax liabilities?

The Service continues to pursue improvement of electronic filing. Each tax year has resulted in the addition of more forms and schedules to the filing of Individual Income Tax Returns electronically. In addition, there are continuing efforts to improve the filing of Business Returns and Employee Plans Returns.

During this 1990 filing season, we have tested the feasibility of filing of "Balance-due" returns in the New England area. We are comfortable with the results of this test and plan to introduce the filing of these returns to select areas for the 1991 filing season.

Whatever processing is present within FFS at the end of its system life will be incorporated into the Integrated Input Processing System (IIPS) at that time.

5. Does filing electronically--with no paper trail that can be examined--make it easier to create fraudulent refund schemes? Have you discovered any fraudulent refund schemes involving electronically filed returns?

Although normal paper trails do not exist for electronically filed returns, there are other ways of identifying potential fraudulent refund schemes on these returns. And, because of Form 8633 and Form 8453, some paperwork is involved.

A Form 8633, Electronic Filer Application, is completed by all individuals who want to participate in the Electronic Filing Program (ELF). Upon receipt of this form in the District, a suitability check is performed and the applicant cleared prior to being accepted for ELF. Grounds for rejection are conviction of Title 18 or 26 or 31 offenses; failure to file timely and accurate tax returns; failure to pay tax liabilities; previous assessment of tax penalties; suspension/disbarment before IRS; facts or conduct of a disreputable nature; and misrepresentations on Form 8633.

Furthermore, ELF procedures require a Form 8453 jurat to be signed by the taxpayer and preparer for each transmission. Form 8453 is the signature document and transmittal for Forms W-2 on electronically filed refund tax returns. The information, when

properly processed, assists the Questionable Refund Detection Teams in obtaining the Forms 8453 to review suspicious Forms W-2.

Additionally, the information from the electronically filed returns is combined with the information from paper returns and is scrutinized to identify potential returns for review. This process has been successful in identifying approximately 45 schemes in 1989 and 1990 involving 134 returns with refunds in excess of $530,000.

Although it is not easier to create fraudulent refund schemes for electronically filed returns, it is definitely easier to obtain the refund before the scheme is detected. This is due to the shortened time frame for processing returns, the procedures for transferring the refund electronically, as well as the difficulty of receiving the Forms 8453 timely. These issues are currently being addressed and alternative measures are under consideration. There have been instances where multiple refunds have been paid to the same person or persons. However, program adjustments have been made to build in time delays if certain criteria of suspicion are present in a transmission, as well as other changes to minimize the risk of fraudulent refunds. Refunds were deleted on approximately 51 percent of the fraudulent refund schemes in 1989 and approximately 60 percent in 1990. In comparison, approximately 85 percent and 95 percent of fraudulent schemes on paper returns were deleted in those same years.

6. Do you foresee the day when the system is "paperless", when virtually all returns will be filed electronically? When?

Though electronic filing is expected to increase in the coming years, there may always be a need to process paper returns. Current trends indicate that factors such as cost to taxpayers and lack of taxpayer acceptance have proved to prohibit or discourage taxpayers from filing by electronic means. Other factors, such as IRS policy changes and tax law modifications, would have to be examined. Based on these factors, the IRS envisions that processing of paper returns will continue in the foreseeable future.

F. <u>COMPUTER PROBLEMS</u>:

1. Why was there a two-week delay for certain taxpayers who filed with the Cincinnati Service Center? Where were the tapes for the two weeks that they were "lost"?

A tape shipment from the Cincinnati Service Center to the Martinsburg Computing Center was delayed at the Delta Airlines terminal at National Airport in Washington, D.C. for 13 days. This shipment contained both paper and electronically filed tax return information, and this information could not be processed or posted to the master file at Martinsburg until the tape

shipment was retrieved. As a result, a two-week delay in processing the information meant those taxpayers expecting refunds would have to wait that much longer.

2. Is the system of transmitting tax information secure? What controls are there to assure that tapes sent from the service centers to Martinsburg are actually received?

The system is as secure as possible given the fact that tax information is transmitted on magnetic tapes, shipped commercially, from service centers to the Martinsburg Computing Center and back to the service centers. There are set procedures for personnel to follow when shipping tapes. These procedures are being enhanced to ensure future tape shipments are not "lost" in the shipping process. Documentation will be sequentially numbered by each separate service center, standard operating procedures will be consolidated into a single document, all centers will acknowledge receipt of a shipment within 24 hours, and couriers will be provided with specific information on all shipments.

The Service is also planning to establish a computer based monitoring system to track all "special shipments" and "replacement files" on a continuing basis, and then have the system evolve into tracking all tape shipments between the centers. The Service will also explore the feasibility of electronically transmitting files between the centers.

3. Are the service centers able to electronically transmit data directly to Martinsburg? Will this system of transmitting data by tape be replaced when the IRS modernizes its computer system?

At this time, only requests for transcript information on select taxpayer accounts are transmitted electronically between the service centers and Martinsburg. This transmission occurs electronically by a tape to tape method. For purposes of processing tax returns, data is only transmitted by tape between the service centers and Martinsburg.

With the modernization of the computer system, the use of tapes will cease and information will be transmitted electronically. The current plan for the IRS modernization calls for expanding electronic interchange capabilities between the service centers, the Martinsburg Computing Center and the Detroit Computing Center through the installation of electronic communication networks.

II. ADMINISTRATION'S FISCAL YEAR BUDGET PROPOSALS FOR IRS:

A. OVERVIEW OF THE BUDGET:

1. IRS originally asked the Administration for $6.37 billion and 119,841 positions. The Administration added $191 million for a new initiative. In total, IRS's request was $400 million over the Administration's request to Congress. What additional programs could have been implemented under your budget request? What additional programs could have been implemented if the Administration had approved the full amount of your fiscal year 1991 appeal?

After the initial submission, the IRS request was amended by $191 million (3,476 average positions) for compliance initiatives. As a result, the comparable budget request for IRS totaled $6,561,4 million and 123,318 average positions.

The primary function reduced during the review by the Administration was in the area of Information Systems. A reduction of $429 million was effected against various projects, such as: Counsel Automated Systems Environment, $13 million; Integrated Collection System, $25 million; Integrated Telecommunications Service, $40 million; Examination Laptop Replacement, $49 million; Service Center Departmental Applications, $16 million; Corporate Systems/Mirror Imaging Acquisition, $75 million; Electronic Federal Tax Deposit System, $7 million; Check Handling Enhancement and Expert System, $11 million; and Automated Taxpayer Service System, $8 million.

2. If IRS received $100 million more than the Administration's budget request, to where would it be allocated?

If the IRS were to receive an increase of $100 million over the Administration's budget request, resources would be utilized to: restore program reductions taken to offset the projected January 1991 pay raise ($58 million), fund the projected postal rate increase to be effective January 1991 ($21 million), and restore funding for various Information Systems projects which were reduced during the Administration's review of the budget request ($21 million).

3. The budget shows savings in fiscal year 1991 of 157 positions from A-76 contracts. This is OMB's program to have agencies save money by contracting out to private parties certain government functions. Has IRS realized any reduction in staffing because of A-76 contracts? What positions have been contracted out? What positions have been studied to determine the feasibility of outside contracting and what were the findings? Has IRS determined what IRS functions will be contracted out in fiscal year 1991 and how this program will work?

Since 1982, IRS has contracted out the work of 532 FTE (full-time equivalent positions) under the A-76 program. There are no specific data available concerning how much of this contracting out resulted in actual staff reductions. In general, the FTE were reprogrammed by the offices involved to meet other needs. Since FY-1986, however, OMB has reduced IRS budget requests by a total of 3,914 FTE in anticipation of future A-76 savings.

The 532 FTE contracted out by IRS under the A-76 Program come from the following functions:

268 FTE	Cash Transaction-Report processing
150 FTE	1040 ES voucher receipt and deposit
30 FTE	Quarterly tax package mailouts
21 FTE	Building management services
63 FTE	Miscellaneous minor functions
532 FTE	TOTAL

Besides the above, fifteen other A-76 reviews have been completed in which the work was kept in-house. These are summarized below:

351 FTE	Engineers and Appraisers
200 FTE	Statistics of Income Division
48 FTE	Miscellaneous minor functions
599 FTE	TOTAL

Seven A-76 reviews are in progress as of May, 1990. The FTE's involved are estimated as follows:

1000 FTE	Distribution of tax forms
1000 FTE	Tax return files
150 FTE	Machine services (mailouts)
150 FTE	Service center print systems
50 FTE	Motor vehicle fleet management
50 FTE	ADP support (four district offices)
50 FTE	Micrographic services
2450 FTE	TOTAL

Although some of these A-76 actions will be completed in 1991, it is difficult to predict which will be contracted out. The decision depends on the results of cost comparisons between government costs and outside bids.

4. In fiscal years 1990 and 1989, the IRS was supposed to eliminate 2,000 positions as part of A-76 contracting out. How many of those functions were contracted out? How many more positions did the IRS need to fund than the 1990 and 1989 budgets provided for because of unrealized A-76 savings?

In fiscal years 1989 and 1990, IRS was supposed to eliminate 2,072 FTE (full-time equivalent positions) under the A-76 program. Of these, 462 FTE were contracted out. The remaining 1,612 FTE had to be funded by IRS.

5. In fiscal year 1988, the IRS requested more staffing and funding than that which is included in the Administration's fiscal 1991 budget request. Has the IRS fallen three years behind in staffing and programs?

The FY 1989 budget request to the Treasury Department represented the amount of resources IRS believed could be optimally be used to address all service programs. When balanced against other government priorities, the ultimate request to the Congress in the President's FY 1989 budget, was considerably less. The FY 1991 President's budget request is a tight budget that assumes and is predicated on our ability to achieve substantial cost savings and productivity gains. Nonetheless, it provides adequate funding for 1991 and, of equal importance, it reflects a long-term commitment to restoring the health of the tax system. The FY 1991 budget proposes a significant increase to support three major areas: modernization of the tax system, collection of additional tax revenues under current law, and maintaining current operations in the light of inflation and growing workload. The $191 million in new funding for compliance activities provided for in the budget represents the growth IRS can prudently manage and absorb during 1991. No more. No less.

6. Please provide a budget chronology for fiscal year 1981 through fiscal year 1991 of staffing and funding levels requested by the IRS to Treasury, Treasury to the Office of Management and Budget (OMB), OMB to Congress, final Congressional action, and actual level realized.

See Attachment B.

7. Please provide a chronology of IRS staffing levels from fiscal year 1981 through fiscal year 1991 estimates in the following areas: revenue agents, revenue officers, special agents, tax examiners, tax auditors, taxpayer service representatives, and taxpayer service specialists (include a description of the position and current salary levels).

The chart below shows IRS staffing levels from fiscal year 1981 through 1991 for the occupations you requested. A brief description for each occupation and current salary levels are also provided.

	Revenue Agent	Revenue Officer	Special Agent	Tax Examiner	Tax Auditor	Taxpayer Service Represen-ative	Taxpayer Service Specialist
1981	13,272	5,323	2,751	N/A*	4,079	932	645
1982	13,554	6,028	2,685	N/A*	3,888	936	647
1983	13,613	7,301	2,593	N/A*	3,821	837	504
1984	13.442	7,531	2,790	N/A*	3,474	1,036	534
1985	13,598	7,397	2,821	N/A*	3,536	1,121	557
1986	13,658	7,265	2,800	N/A*	3,317	1,302	606
1987	15,036	7,340	2,728	6,820	3,184	1,700	735
1988	16,720	8,340	2,890	1,363	3,310	2,221	1,004
1989	16,623	8,179	2,998	2,107	3,38	2,650	1,273
1990**	15,735	8,293	2,744	7,949	3,146	2,428	1,311
1991**	16,349	8,941	2,813	8,571	3,095	2,443	1,318

* For 1981-1986, data is not available under this employment category.
** For 1990-1991, the figures represent budget estimates.

DESCRIPTION OF POSITIONS

Revenue Agent
Internal Revenue Agents are professional accountants who examine and audit the books of individual and corporate taxpayers to determine their correct Federal tax liabilities. This work requires daily contact with taxpayers, tax attorneys and certified public accountants. Examinations are normally conducted at the taxpayer's place of business.

The entry level for the Revenue Agent occupation is typically GS-5 ($16,305) and GS-7 ($20,195), with GS-11 ($29,891) the full performance level. GS-12 ($35,825) and GS-13 ($42,601) are working level grades above the full performance level.

Revenue Officer
Revenue Officers are highly trained professionals responsible for protecting the interests of the Federal Government by obtaining maximum compliance with the law for the filing of tax returns and payment of tax. They also protect the interests of the taxpayers by helping them to understand and meet their tax obligations.

Revenue Officers perform their work on a case by case basis. They conduct research, interviews and investigations, analyze financial statements, and contact third parties for information. They use a variety of collection enforcement techniques (such as summonses, liens, seizures, and referrals) to collect delinquent tax accounts and secure delinquent tax returns.

The entry level for the Revenue Officer occupation is typically GS-5 ($16,305) and 7 ($20,195), with GS-9 ($24,705) the full performance level. GS-11 ($29,891) and GS-12 ($35,825) are working level grades above the full performance level.

Special Agent
Special Agents conduct investigations of alleged criminal violations of Federal tax laws, particularly those relating to income, excise and employment taxes; make recommendations with respect to criminal prosecution and the assertion of appropriate civil penalties against taxpayers; prepare comprehensive documented technical reports, including accounting analyses and summaries; assist the United States Attorney in the preparations of the cases for trial; and testify in court as key government witnesses.

The entry level for the Special Agent occupation is typically GS-5 ($16,305) and GS-7 ($20,195), with GS-11 ($29,891) the full performance level. GS-12 ($35,825) to GS-15 ($59,216) are working level grades above the full performance level.

Tax Examiner
Tax Examiners perform work which involves the processing of original tax and information returns, establishing taxpayer account records or changing such records based on later information affecting taxes and refunds; collecting some taxes and/or obtaining tax returns; computing or verifying tax, penalty, and interest; and determining proper tax liability.

Tax Examiner grades range from a GS-3 ($12,982) Tax Examining Clerk to a GS-8 ($22,367) Tax Examining Assistant, depending upon the specific job and the specialty area of work.

Tax Auditor
Tax Auditors determine correct Federal tax liabilities based on information provided by individual wage earners, business people, professionals, and other taxpayers. Examinations are normally conducted in Internal Revenue district offices.

The entry level for the Tax Auditor occupation is typically GS-5 ($16,305) with GS-9 ($24,705) the full performance level.

Taxpayer Service Representative
Taxpayer Service Representatives provide quality answers to specific walk-in and telephone inquiries by taxpayers on tax

returns, to resolve account problems, and to refer highly technical questions to a Taxpayer Service Specialist. Taxpayer Service Representatives also assist taxpayers with balance-due notices by arranging part-payment agreements.
The entry level for the Taxpayer Service Representative occupation is typically GS-4 ($14,573) with GS-7 ($20,195) the full performance level.

Taxpayer Service Specialist
The Taxpayer Service Specialists provide accurate and complete assistance to taxpayers on a full range of taxpayer problems within the Taxpayer Service jurisdiction. Taxpayer Service Specialists serve as classroom lower-graded and less experienced technicians with research on technical issues and they make public appearances on television, radio and at outreach seminars,

The entry level for the Taxpayer Service Specialist occupation is typically GS-5 ($16,305) with GS-9 ($24,705) the full performance level.

8. Please provide the staffing and funding levels for each IRS program from fiscal year 1978 through fiscal year 1991 estimates.

See Attachment C.

9. Please provide a comparison of IRS key workload indicators from fiscal year 1981 through fiscal year 1991 estimates, to include tax returns filed, taxpayers assisted, tele-tax contacts, level of telephone service, examination coverage rates, delinquent accounts closed, delinquent returns secured, tax fraud investigations, employee plan determination letters and examinations, exempt organization determination letters and examinations, and accounts receivable inventory data.

KEY WORKLOAD INDICATORS: FISCAL YEARS 1981 TO 1991

RETURNS FILED (in thousands)

1981	94,018
1982	95,482
1983	95,284
1984	96,288
1985	99,426
1986	102,393
1987	103,460
1988	106,994
1989	110,253
1990	111,487 (estimate)
1991	111,997 (estimate)

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TAXPAYER SERVICE

Fiscal Year	Taxpayers Assisted	Tele-Tax Contacts	Level of Service
1981	44.8M	N/A	70.0%
1982	47.8M	N/A	71.0%
1983	49.1M	1.8M	8.6%
1984	53.6M	3.4M	79.5%
1985	58.9M	8.3M	72.2%
1986	54.8M	7.9M	81.0%
1987	53.2M	10.9M	77.0%
1988	59.8M	13.4M	84.5%
1989	78.4M	27.8M	79.6%
1990	71.4M *	30.OM *	71.6% (THRU 4/28/90)
1991	FIGURES NOT YET AVAILABLE		

* Projected

AUDIT COVERAGE RATES

Fiscal year	Coverage
1981	1.84
1982	1.63
1983	1.56
1984	1.31
1985	1.34
1986	1.12
1987	1.10
1988	1.03
1989	0.93
1990 projected	0.85
1991 plan	1.03

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TAXPAYER DELINQUENT ACCOUNTS AND RETURNS SECURED
(In Thousands)

	81	82	83	84	85
TDAs Disposed	2,180	2,360	3,101	3,244	2,731
Returns Secured	1,329	1,491	3,804	3,951	3,771

	86	87	88	89
TDAs Disposed	2,419	2,631	2,617	2,847
Returns Secured	3,791	4,154	3,825	4,536

Estimated	90	91
TDAs Disposed	3,126	3,400
Returns Secured	5,936	5,658

TAX FRAUD INVESTIGATIONS INITIATED

1981	5838
1982	6498
1983	5910
1984	6194
1985	6065
1986	5861
1987	5511
1988	4899
1989	5417
1990	4974 (estimate)
1991	5118 (estimate)

EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS
Determination Case Disposals

Year	EP	EO
1981	139,192	48,686
1982	151,531	52,372
1983	143,345	54,387
1984	112,822	61,540
1985	149,451	60,618
1986	354,053	58,941
1987	321,839	59,874
1988	166,047	55,159
1989	94,104	54,821
1990	106,000*	53,500*
1991	252,000*	54,000*

* Projected

EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS
Examinations Conducted

Year	EP	EO
1981	20,207	20,102
1982	18,368	21,398
1983	22,024	22,403
1984	27,734	20,632
1985	24,542	19,609
1986	20,519	21,837
1987	8,669	18,094
1988	20,543	11,907
1989	36,681	15,193
1990	37,900*	14,100*
1991	39,900*	14,700*

* Projected

ACCOUNTS RECEIVABLE INVENTORY

1981 - 1983 Not Available
1984 - $31.9 billion
1985 - $43.6 billion
1986 - $47.6 billion
1987 - $53.7 billion
1988 - $59.0 billion
1989 - $66.5 billion
1990 ESTIMATE NOT YET AVAILABLE
1991 ESTIMATE NOT YET AVAILABLE

B. REVENUE INITIATIVES INCLUDED IN THE BUDGET:

1. The Administration's budget shows a $2.5 billion increase in revenue collected by reallocating existing resources into areas which have a higher revenue yield. Please provide a description of the areas where staff and funding will be taken from and the areas to which staff and funding will be added and the revenue yield for each. Also, provide a comparison of the staffing and funding levels in the affected areas over the past three years.

IRS is taking management actions to accelerate the closing of cases in Examinations, Appeals, and Employee Plans, resulting in $2.5 billion in additional tax revenue.

- Counsel / Appeals Large Case Initiative

IRS will accelerate the closing of 47 targeted large

Appeals cases, each with dollars in dispute exceeding $10 million. A staff redirection of 145 FTE from Examination will be required.

- Employee Plans Small Plan Actuarial Initiative

  Resources will be diverted from low-yield coverage cases in the Employee Plans program to examine 17,300 additional plans for plan years 1986 - 1988.

- Coordinated Examination Program Authority Initiative

  The establishment of settlement authority at the Examination Program case level will result in earlier resolution of issues and collection of deficiencies and interest. Thirty percent of the cases now ending up in Appeals will be settled earlier.

- Examination Tax Shelter Initiative

  By targeting key tax shelter cases, IRS will accelerate the closing of an additional 50,000 cases from Examination into Appeals.

- Examination Excise Tax Initiative

  IRS will redirect 150 FTE in Examination from low yield audits to higher yield excise tax administration.

Comparison of Staffing (Amounts in Millions)

	FY 1988 FTE	Amount
Examinations	32,246	$1,288.9
Appeals & Tax Litigation	4,780	$ 231.4
Employee Plans	1,798	$ 78.0

	FY 1989 FTE	Amount
Examinations	31,190	$1,319.4
Appeals & Tax Litigation	5,222	$ 232.9
Employee Plans	1,947	$ 83.7

	FY 1990 FTE	Amount
Examinations	31,282	$1,423.7
Appeals & Tax Litigation	5,227	$ 288.9
Employee Plans	1,832	$ 84.6

	FY 1991 FTE	Amount
Examinations	32,325	$1,597.1
Appeals & Tax Litigation	5,304	$ 308.8
Employee Plans	1,810	$ 88.3

2. The Administration's budget also provides an increased funding for tax law enforcement. Please provide a description of each of the areas covered by the proposal, the staffing and funding levels for each, the revenue yield, and the reason increased enforcement is necessary in that area.

The Internal Revenue Service is proposing a series of new compliance enforcement initiatives in FY 1991 at a cost of $191 million. The initiatives serve both short and long term revenue objectives, and are intended to produce direct enforcement revenue as well as promote better voluntary compliance.

- Collection of Unpaid Taxes

  In order to lower the inventory and value of outstanding accounts receivable, the IRS will close an additional 60,151 accounts and collect an additional $150 million in FY 1991, at a cost of 1,050 FTE and $55.5 million.

- Examination Field Audits

  IRS will expand the auditing of tax returns in district offices to increase compliance and raise additional revenue. Due to the time lapse between the initiation of new audits to actual collection of additional tax due, significant revenues will not accrue until FY 1992, but increase substantially thereafter, producing $1.1 billion in additional tax collections through FY 1995. The cost of this initiative is 1,176 FTE and $77.1 million.

- Examination of Correspondence Audits

  IRS will collect an estimated $144 million in additional tax collections in FY 1991 through increased service center correspondence audits and contacts, at a cost of 640 FTE and $27.3 million.

- Examination Claim Audits

  In expanding the auditing of claims filed against the government by taxpayers due to changes made to the originally filed tax returns, starting in FY 1991, the IRS will begin to accrue significant revenue in FY 1992 ($111 million). The cost of this initiative is 146 FTE and $7.9 million.

- Examination Contract Training

  IRS will contract out the training of new revenue agents at a cost of $7.5 million, enabling experienced agents formerly used to train new recruits to continue auditing returns, resulting in an estimated $14 million in additional tax collections in FY 1991.

- Returns Processing Pre-1985 Non-Custodial Agreement Initiative

  IRS will validate deductions claimed for dependents by non-custodial parents under pre-1985 agreements. It is estimated this will result in the collection of $173 million in additional taxes in FY 1991, at a cost of 366 FTE and $12.3 million.

- Returns Processing Dependent Social Security Number Matching Initiative

  By increasing document matching and following up on dependent social security numbers provided on tax returns, IRS will collect an estimated $58 million in additional taxes in FY 1991, at a cost of 84 FTE and $2.9 million.

- Returns Processing Mortgage Interest Credit Initiative

  IRS will follow up on information provided on tax returns to determine the validity of tax credits claimed for mortgage interest, collecting an estimated $18 million in additional tax revenue in FY 1991 at a cost of 14 FTE and $500,000.

3. The Administration's budget includes a revenue initiative for enhanced enforcement of certain small pension plans. The two tax issues involved relate to interest rate and age actuarial assumptions. Please provide a description of the scope of the initiative, reason(s) for the initiative, the types of taxpayers and plans involved, and several factual examples illustrating the problem.

The program has as its basis a longstanding effort to

address what the Service considers to be improper tax practices in the case of a small number of defined benefit plans. Specifically, the Service is questioning the funding of defined benefit plans where the annual pension contribution claimed per participant indicates that the plan may have:

1. used an inappropriate funding method,
2. exceeded the maximum benefit limitation under section 415,
3. employed an unreasonably low interest rate not supported by the facts and circumstances of the plan. (In the plans adjusted among the first 500 cases closed, the average interest rate used was 5.2%), or
4. employed an unreasonably low retirement age not supported by the facts and circumstances of the plan. (In the plans adjusted among the first 500 cases closed, the average retirement age used was 57.)

In a substantial number of our cases, all or most of the contribution is disallowed due to the "legal issues" listed above (e.g., funding method or section 415) without ever reaching the interest rate and retirement age assumption issues.

Contributions to these plans are tax deductible. By utilizing one or more of the practices cited above, employers can take excessive deductions. Such deductions may come to hundreds of thousands of dollars annually per plan.

LITIGATION HISTORY

In the summer of 1988, the United States District Court for the Central District of Illinois decided in the Service's favor in a case called Mirza v.IRS. The Seventh Circuit Court of Appeals affirmed this decision unanimously in August 1989.

The court held that an employer must base his funding assumptions on "experience and reasonable expectations". Among other things, the plan in Mirza utilized a 5% assumption at a time when safe investments were yielding 12% or more. In Mirza, the appellate court disallowed $510,000 in deductions claimed for the one year in question (1980). On May 14, 1990, the United States Supreme Court refused to hear the taxpayer's appeal.

The Service's position with respect to the reasonableness of actuarial assumptions is that they are determined on the

facts and circumstances of the particular case. This was the position that the Service took in Mirza and it continues to be our position.

In addition to the Mirza case, we have over 30 cases in litigation on these issues. Every case that has been completed has been resolved on terms highly favorable to the government. Fifteen Tax Court cases that were on the docket for trial in March in California were recently settled for an average of 90% of the claimed deficiency. Of the 20 court cases now resolved, $3.2 million has been disallowed, an average of $160,000 per case.

PROGRAM SCOPE

The program is designed so that only 18,000 plans are examined out of a universe of over a half million. The primary selection criterion used is amount of annual contribution per participant, not interest rate or normal retirement age. The program was expanded late in 1989. The expansion was based on the convergence of three events: (1) the appeals court decision in Mirza, (2) our developing the ability to identify with some precision the filers who are claiming the largest deductions for contributions to these plans (thereby indicating the possibility that questionable actuarial assumptions may be used), and (3) our developing computer programs which enhance the skills of our agents to conduct audits of these plans. The program has been identified as one of the Service's Management Initiatives and is included as such in the President's 1991 budget.

We want to emphasize that the Service would conduct this program even if it were not identified separately in the budget. As indicated by the significance of the disallowed deductions in the Mirza case and in the cases that have been settled to date, we would be remiss if we did not vigorously pursue these issues.

Our research shows that over 98% of plans reporting over $100,000 in contributions per participant (that segment of plans that tends to employ the improper practices noted above) are in the 1-5 participant plan sector. Within the universe of defined benefit plans that are not under examination, the average retirement age and interest rate assumptions used by actuaries are significantly higher than the average age and interest rate of 57 and 5.2%, respectively, for plans changed as a result of our examinations.

Economically, most large plan sponsors seek to control the cost of the total compensation package, including the retirement plan contributions, whereas sponsors of very

small plans tend to try to maximize the amounts that can be legitimately sheltered from current income. A large plan tends to have accumulated hard data about the plan's past experience, including investment earnings and patterns in employee mortality, turnover, and retirement. Most of the small plans coming within the audit program, especially the one-participant plans, were established after the TEFRA (1982) law changes, many in 1984-85, and have little or no investment experience. Naturally, a very small plan would have no experience with the employee data. In the absence of plan experience, the actuary looks more closely at expectations about the future. In those few situations in past years where we have found a large plan employing questionable funding method and actuarial assumptions of this sort, we have taken steps to correct the problem-- that is, we disallow deductions where appropriate.

EXAMINATION RESULTS

The average contribution per participant to a defined benefit plan is less than $5,000. In the approximately 500 cases which our agents have completed examining to date, the average annual pension deduction claimed was $215,000, with eleven individuals claiming over $600,000 in annual pension deductions and forty-eight others claiming over $300,000. In these cases, the average adjustment recommended by the agent was $194,000. Our experience thus far shows that over two-thirds of our cases involve plans of doctors and lawyers; the rest consists of other such highly paid professionals as advertising and real estate executives. Most of these plans have been designed by the pension consultant or actuary to benefit only the highly paid professional and not his or her employees.

4. The fiscal year 1991 tax shelter initiative would accelerate the examination and closure of key tax shelter cases. By the end of March, the IRS was to have identified 35 of the largest key cases. How did IRS develop an initiative in this area without already identifying key cases? How many tax shelter cases did the IRS project would be closed under this initiative? Describe the types of tax shelters and issues involved in these cases.

The objective of the initiative is to close an additional 58,000 investor cases. Our history with tax shelter cases and our knowledge and management of the investor inventory, as well as discussions with field personnel who manage and are responsible for the inventory, was utilized to develop this initiative. To accomplish this objective, the key cases were stratified to target the key cases with the largest number of investors. The type of shelters involved include real estate, commodities, equipment, leasing, and oil and gas ventures. The issues include overvaluation of basis through the inflated value of the assets

to provide the investors with tax credits and deductions to reduce their tax liabilities.

5. The IRS has been targeting closure of tax shelter cases for years; therefore, would it be fair to assume the current inventory is comprised of the most difficult cases to close? What makes the IRS think these taxpayers will settle-up now if they rejected previous attempts to resolve their disputes?

These are mostly projects which have already been advanced substantially toward resolution by trial and/or opinion, and many are in "settlement processing" status.

The emphasis of this initiative is to streamline our processing to move the cases through the system. We are tailoring settlement procedures in order to make processing more efficient, and we are allocating resources to prepare reports and assess the liabilities more expeditiously.

6. The IRS plans to devote additional resources to the examination of excise tax returns. What are the areas of excise tax noncompliance that the IRS will target in fiscal year 1991?

The additional resources planned for fiscal year 1991 will be devoted to all areas of excise tax noncompliance. However, the largest portion of the additional resources will be applied to examining the taxes dedicated to the Highway Trust Fund, including the excise tax on gasoline and diesel fuel.

C. BUDGET PROPOSALS FOR IRS FUNCTIONS:

Taxpayer Service

1. Last fall, during the fiscal year 1991 budget discussions, the IRS indicated opposition to the Administration's plan to include revenue in fiscal year 1992 related to the charging of a user fee to taxpayers requesting assistance from the IRS on the telephone. A November 1989 Treasury memo to OMB noted that "Treasury will continue to work with vendors" to develop a program for the taxpayer service telephone user fee. Is the Administration still thinking of charging taxpayers for telephone assistance when there is a one-in-four chance they'll get a wrong answer? Does the "other user fee" category of the Administration's budget include revenue from the telephone user fee in fiscal year 1992?

The IRS in conjunction with staff from Treasury and OMB have completed a study of the feasibility of charging a user fee to taxpayers requesting assistance from Taxpayer Service. Although it was determined that the technology to do this does exist, or will be developed soon, a recommendation was

made not to implement a user fee due to the costs involved. Although the Service would no longer pay circuitry costs for the taxpayer's call, the cost to the caller would be approximately three times what the cost of the call is now. This report has been provided to Treasury and discussed by them with OMB. The "other user fee" category of the Administration's budget does include revenue of $ 20.5 million from a telephone user fee in fiscal year 1992.

2. Taxpayers are finding it more difficult to reach the IRS telephone assistance program this year. There are twice as many taxpayers who receive a busy signal as those who receive an assistor. The fiscal year 1990 budget states there would be an 85% level of service, and in fact IRS is showing only 70% level. The fiscal year 1991 budget indicates there will be an 80% level of service despite a decrease in the number of taxpayer assistance positions. How is that possible and what is the true level of service that can be expected under this budget?

Our FY 1990 budget request contained a proposed staffing level of about 8,200 positions for our Taxpayer Service function. Because of actions taken to meet the demands of pay absorption, sequestration and increased labor costs, we will realize about 7,600 positions. Also, about 75 positions in this difference between the original FY 1990 budget and this year's presentation is attributable to the comparability adjustment for appropriation restructuring. Those positions pertain to internal audit, security and information systems projects that are now being separately budgeted. Current plans call for us to expend in excess of $376 million, which is slightly more than the $374 million we proposed in the FY 1990 budget request.

3. What will be the accuracy rate if the Administration's fiscal year 1991 budget proposal is approved?

If the Administration's fiscal year 1991 budget is approved, we expect a continued improvement in our accuracy rates.

Examination

1. Compare the audit coverage for 1989, 1990, and the 1991 budget with a breakdown by income level for individuals and asset size for corporations.

Audit coverage for 1989 and estimated rates for 1990 and 1991 are shown below, grouped into the same categories as the tax gap report.

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Audit Coverage by Tax Gap Classification

	FY 89	FY 90	FY 91
Sole Proprietorship	2.00	1.76	2.01
Informal Supplier:			
Non-Business	0.84	0.72	0.84
Business	2.00	1.76	2.01
Total Individual	0.92	0.79	0.92
Small Corps (<10M)	1.61	2.32	2.50
Large Corps (>10M)	25.51	21.41	40.67

2. The fiscal year 1991 audit coverage may fall below one percent. Is that acceptable?

At this time, we are planning for an audit coverage of 1.03 percent in FY 1991. Audit coverage has shown a steady decline over the years. Several factors have contributed to this decline, including the increase in return filings and the time required to examine a return. Since IRS believes it would be desirable to maintain coverage at a higher level, we are developing initiatives that would further increase audit coverage in later years.

3. What is the impact of an audit rate of less than one percent on voluntary compliance? Please provide the voluntary compliance levels from fiscal year 1981 through fiscal year 1991 estimates. How much revenue is lost for each drop of one percent in the voluntary compliance level?

The audit coverage rates for both individuals and corporations have been declining in recent years (which may be partially offset by other enforcement programs, such as the Information Returns Program). Only among individual income tax returns is the audit coverage rate likely to drop below one percent. The impact of changes in the audit coverage rate on the gross tax gap (i.e., on voluntary compliance) is referred to as the indirect revenue effect of examinations, and consists mostly of the so-called "ripple effect": the change in voluntary compliance among those who have not been examined that arises from a change in the audit coverage rate. There is no consensus among researchers as to the magnitude of this indirect effect, but most agree that it is significant and positive. If so, then declining audit coverage would indirectly increase the gross tax gap.

We estimate and project the voluntary compliance rate--the percentage of legal-sector income tax liabilities that

taxpayers voluntarily pay--for selected tax years. Our estimates of selected voluntary compliance rates from 1981 through 1992 are shown in the attached chart. (See Attachment D.)

Collection

1. The proposed budget for Collection shows an increase of 1,356 positions and $119 million. Approximately 1,000 of these positions and $51 million will be devoted to an accounts receivable initiative. What are you going to do? What will the currently-not-collectable inventory and the accounts receivable inventory be at the end of fiscal year 1991 if this initiative is funded? What would these levels be if this initiative is not funded?

The objective of the initiative is to collect an additional $150.2 million by closing 60,000 Taxpayer Delinquent Accounts (TDAs) between October 1, 1990 and September 30, 1991. IRS will hire over 900 Collection employees who will be assigned to the various Collection operations in the service centers, Automated Collection System (ACS) call sites and field offices. Our goal is to make full use of the space and equipment available at our service centers and ACS sites by first increasing staffing there to optimum levels. We will then assign additional revenue officers to the Collection field offices with the most severe inventory problems.

The primary benefit of this increase in Collection staffing will be increased dollars collected from delinquent accounts. We have not estimated the impact of the new hires on the total inventory or the currently-not-collectible (CNC) portion. We do estimate that Taxpayer Delinquent Account (TDA) inventory will be $197 million less with the initiative than without it. The total Accounts Receivable Dollar Inventory (ARDI) is composed of many types of accounts, some of which are not sensitive to additional collection staffing. Collection actions do not generally dispose of cases in litigation, bankruptcy, or awaiting adjustments.

2. In 1986, the number of positions devoted to investigating delinquent returns was 10% higher than that which is proposed for fiscal year 1991 (from 3,678 in FY 1986 to 3,363 in FY 1991). Why is the IRS devoting fewer positions to the delinquent returns program?

While the proposed staffing for FY 1991 is less than that for FY 1986, we estimate that assessments will increase by over 60% (from $7.4 billion in FY 1986 to $11.9 billion in FY 1991). Through increased use of automated systems and

better case selection throughout the delinquent returns program, we are able to increase assessments with fewer staff resources.

3. The IRS budget increase for Collection staffing appears to fall short of the increases needed for two collection initiatives (1,000 staff years are needed for a fiscal year 1991 initiative, and an additional 800 positions are needed to complete a fiscal year 1990 initiative that has been delayed due to IRS budget shortfalls this year). By how much will each affected collection program be reduced in fiscal year 1991 from the current fiscal year 1990 levels?

The Collection staffing increase for FY 1991 is approximately 1,350 FTE over the FY 1990 level. This net increase results from 1,800 additional FTE (for the FY 1991 initiative and annualiztion of the FY 1990 initiative) less 450 FTE for a program reduction to cover pay costs, an A-76 reduction, and an ADP reapplication. Collection programs will thus operate at a FY 1991 level some seven percent higher than the 1990 level.

Employee Plans and Exempt Organizations (EP/EO)

1. In fiscal year 1991, the IRS estimates that it will review 252,000 employee plan amendments, plan terminations, and new plan applications, as compared with 106,000 in fiscal year 1990. Further, the budget shows an increase in the employee plan and exempt organization audit rates. Yet, the budget proposes to handle this extra work with a decrease in the number of positions. How is this possible?

The number of employee benefit plan amendments, plan terminations and new plan applications fluctuates greatly from year to year as a function of the effective dates of new or revised laws. The significant increase in applications in FY 1991 results from plans amending to conform with the Tax Reform Act. The Service will be able to issue a much greater number of determination letters in FY 1991, even with fewer employees, owing to the use of a variety of accelerated processing methods:

-- Expanded use of the Master and prototype Volume Submitter and Regional Prototype programs will allow the Service to process applications from a larger number of adopters of these pre-approved plans. These plans can be quickly reviewed by a technical screener with a limited number having to be assigned to a group for in-depth review.

-- Limiting the scope of the review of applications to those issues which have the greatest potential for adverse impact on participants. In the past, many of these cases were

fully reviewed resulting in changes to the plan document which were inconsequential.

2. Since the EP/EO staff decreases in fiscal year 1991, what current programs in the employee plan and exempt organization functions are being cut back in fiscal year 1991 in order to handle the increased workload?

As indicated in our response to the previous question, accelerated processing methods will enable us to issue a greater number of determination letters with fewer employees. Accordingly, we do not foresee the FY 1991 staff decrease causing any reduction in our current programs.

3. Exactly what issues will EP/EO be focusing on and at what staff and funding levels?

Employee Plans will focus on promptly issuing determination letters to plans amending to conform with the Tax Reform Act as well as old plans terminating and new plans being established. Examinations of employee benefit plans will continue to focus on protection of plan participants' benefits and regulating plans' operating compliance with statutory requirements. Special emphasis is expected to be placed on the following issues: use of reasonable actuarial assumptions used in calculating contributions to defined benefit pension plans and follow through adjustments to Forms 1040 and 1120 based upon corrections of excessive contributions to pension plans. Exempt Organizations will focus on promptly issuing determination letters to organizations seeking recognition of tax exempt status. Examinations of exempt organizations will continue to focus on regulating organizations' operating compliance with statutory requirements for maintaining tax exempt status and protection of the public's rights relating to the obligations of exempt organizations. Special emphasis is expected to be placed on the following issues: Charitable solicitations and fund-raising activities of charities, proper reporting of unrelated business income, employment taxes, follow through adjustments to Forms 1040 and 1120 based upon allocation of expenses among taxable and tax exempt subsidiaries of exempt parent organizations.

The EP/EO FY 1991 Congressional Budget requested 2,650 average positions and $129.1 million. We anticipated that resources would be divided between Employee Plans (70%) and Exempt Organizations (30%). We anticipated Employee Plans resources to be devoted to conducting examinations (55%) and to issuing determination letters (45%). Exempt Organizations resources are anticipated to be devoted to examinations (75%) and to determinations (25%).

4. Please provide the employee plan audit coverage and exempt organization audit coverage, according to plan or organization size, in fiscal years 1989, 1990 and 1991 estimates.

The following table provides our employee plans and exempt organizations audit coverage; employee plans by number of plan participants and exempt organizations by organization type. Although all organizations recognized as exempt from federal income tax are not required to file an annual return, for purposes of our analysis, we determine coverage based on total returns filed.

	1989 (actual)	1990 (projected)	1991 (projected)
EP Examinations:			
-Plans with 100 or more participants	2,959	2,773	2800 - 3000
-Plans with less than 100 participants	27,446	28,485	29,000 - 30,800
-Self-employed individual plans	414	0	0
-Income/Excise Tax returns	4,157	4,176	4100 - 4300
-Sole Proprietor and Spouse/ Partners and Spouses Plans	1,705	2,467	2800 - 3000
Total of Examinations	36,681	37,900	39,900
Total Returns Filed	1,022,985	1,058,414	1,093,844
- Composite Coverage Rate	3.59%	3.58%	3.65%

	1989 (actual)	1990 (projected)	1991 (projected)
EO Examinations:			
-Private Foundations	1,483	1,143	1200 - 1400
-Public Charities	4,262	3,257	3300 - 3500
-Civic Associations	859	860	800 - 1000
-Labor Organizations	994	691	600 - 800
-Business Leagues	2,127	860	800 - 1000
-Recreation Clubs	2,682	959	900 - 1100
-All Other 501(c) Organizations	1,999	931	900 - 1100

-Farmers' Coop.	198	324	200 - 400
-Political Organizations	--	169	100 - 300
-Employment Tax Returns	589	1,932	1900 - 2100
-Related Forms 990-T	1/	2,623	2600 - 2800
-Related Form 4720	1/	239	200 - 400
Total of Examinations	15,193	14,100	14,700
Total Returns Filed	456,090	477,902	486,399
= Composite Coverage Rate	3.30%	2.95%	3.02%

1/ Included in the above figures for FY 1989.

Tax Fraud and Financial Investigations

1. The IRS continues to drop the number of positions devoted to the General Enforcement Program (GEP) which is responsible for activities involving questionable refund schemes, offshore banking, and tax havens. At the same time the IRS is increasing the number of positions devoted to the Special Enforcement Program, which is responsible for money laundering and narcotics traffickers. Has there been a shift in priorities at the IRS toward drug enforcement activity or is there a decrease in the activity targeted by the General Enforcement Program? What impact does GEP staffing have on overall compliance?

There have been increases in the program delivery of enforcement activity relative to narcotics-related crimes. These increases have been accompanied by small decreases of enforcement activity in some areas of the General Enforcement Program (GEP). The increases in narcotics-related enforcement are a result of anti-drug legislation and Presidential initiatives which have placed additional enforcement responsibilities upon the Internal Revenue Service (IRS). To respond to these changes, the IRS has increased its commitment toward these Special Enforcement Program-type cases.

The General Enforcement Program has not yet been negatively impacted. The case-related activity required in several projects or programs, which had been included in GEP, has been significantly reduced, enabling more resources to be devoted to narcotics and money laundering activities.

Both SEP and GEP staffing have a positive impact upon overall compliance. The impact relative to GEP staffing, however, may be greater as it is easier for the public to identify with the type of individuals being investigated in GEP investigations.

Appeals, Tax Litigation and Technical

1. The technical function at the IRS explains to taxpayers and IRS personnel the application and interpretation of our tax laws and, according to the budget, "facilitates taxpayer compliance." In 1989, there were 12,000 requests for assistance in the technical ending inventory. In fiscal year 1991, there will be three times that amount, 34,200 cases pending in the technical ending inventory. Why is the technical inventory increasing? What advice do you give to IRS employees and taxpayers who are waiting for technical assistance?

The ending inventory estimate of 34,200 appears in the fiscal year 1991 Congressional Budget Submission. This figure was determined by adding receipt projections and subtracting closure projections from the prior year's ending inventory. Receipt and closure projections were first submitted in the spring of fiscal year 1989 and, due to a reorganization in Technical in October, 1988, the closure estimates for fiscal years 1991 and 1992 were greatly understated. This understatement of closures produced erroneous and increasingly high inventory projections for Technical in the budget submission.

The fiscal year 1992 budget submission has revised the receipt, closure and ending inventory figures. Closures have been projected to be in the range of 22,500 for fiscal years 1990 through 1996 and are based on the actual closures for fiscal year 1989. Using these new projections. the ending inventory for fiscal year 1991 is estimated to be 13,700.

The Associate Chief Counsel (Technical) is currently evaluating the letter ruling program to devise ways to increase efficiency and timeliness. A number of changes in procedures should be forthcoming. We anticipate these changes will increase the rate of closures and decrease the ending inventory.

Internal Audit

1. How has the creation of an Inspector General (IG) at the Department of Treasury affected the IRS's Internal Audit and Internal Security Divisions? How much money did IRS transfer to Treasury to fund the IG in fiscal year 1990? How much is proposed for transfer in fiscal year 1991?

Since the enactment of the Inspector General Act Amendments in late 1988, IRS has worked with the new Inspector General to strengthen the Treasury Inspector General's Office so that it can provide effective oversight of IRS's activities. This oversight consists of direct investigation of allegations involving certain IRS employees, and oversight of IRS's Internal Security and Internal Audit activities. In January 1990, the Deputy Secretary approved an agreement worked out between the Commissioner and the Inspector General.

This agreement provides that the Office of the Inspector General will have the following responsibilities:

- the investigation of all allegations of misconduct concerning the Commissioner, the Senior Deputy Commissioner and Inspection employees;

- the investigation of all other allegations of misconduct where the independence of Inspection may be questioned. Thus, all allegations of misconduct involving IRS executives and managers (GM-15 and above) and all other allegations involving significant or notorious matters will be referred to the Inspector General's Office;

- the oversight of Inspection activities; and,

- the conduct of special reviews of IRS operations deemed appropriate by the Inspector General.

In fiscal year 1990, IRS transferred 16 staff years and $1.6 million to the Office of the Inspector General. The fiscal year 1991 budget proposes adding an additional 5 staff years and $0.3 million on top of the FY 1990 transfer, to complete the transfer from IRS and make it permanent. The fiscal year 1990 transfer has allowed the IG to begin implementing activities as stipulated in the agreement. Funds for both transfers will come primarily from IRS resources other than those allocated to the Chief Inspector.

2. Will the IRS be funding the Internal Audit and Internal Security divisions in addition to transferring additional funds to Treasury for the Treasury IG?

Of the 21 staff years being permanently transferred to the Treasury IG in fiscal year 1991, only 3 staff years are coming from Internal Security and none from Internal Audit. The 3 staff years transferred from Internal Security represent work to conduct investigations on high-level IRS officials. Under the IG agreement, this work will be performed by the IG and, therefore, Internal Security will have no need for the 3 staff years.

The Service is not internally transferring any additional resources to Internal Audit and Internal Security since Inspection has requested an increase of 125 staff years (72 for an Internal Audit initiative and another 53 associated with a revenue initiative) in fiscal year 1991.

3. Internal Audit will be completing 25% more cases (404 in total) in fiscal year 1991 than completed this year. Why are the number of cases increasing to such a large degree in one year?

Between FY 1980 and FY 1988, Internal Audit staffing decreased 13% while Service staffing was increased nearly 26%. GAO documented this overall 39% decline in Internal Audit resources in their report entitled Managing IRS (GGD-89-1) and pointed out that it had left Internal Audit far short of being able to provide minimum coverage to IRS programs.

When the Service began to transfer additional resources to Internal Audit in [illegible] 1989 to make up for the decline noted by GAO, the resources were applied to audits of system modernization projects. By the time of our FY 1991 request, we could provide minimum coverage to most of the system modernization projects and began focusing on auditing programs at the local level. Therefore, with an overall FY 1991 Internal Audit request of 94 FTE (72 for an initiative for protection of integrity and another 22 associated with revenue initiatives), we could provide audit coverage to 75 assessable units found in IRS districts and service centers, a 23% increase over FY 1990's level of coverage.

Returns Processing

1. The budget proposes an additional 135 positions for returns processing in fiscal year 1991. Yet, the budget indicates that an additional 383 positions are needed for a revenue initiative and an additional 157 positions are needed to handle the processing and printing of millions more tax returns and supplemental documents. How will the IRS handle additional work for 540 positions by only adding 135 positions?

The 135 additional positions in the fiscal year 1991 Budget for Returns Processing are the net increase between 540 positions as stipulated above which were offset by two major program reductions and several minor resource transfers. We were required to absorb 292 positions for the pay increase which we plan to accomplish through productivity. We also proposed to save 141 positions through increased service center A-76 programs. We plan to redirect these, together with resources from less critical areas, to the revenue initiative and to process the additional tax returns.

III. FISCAL YEAR 1990 BUDGETARY SHORTFALL:

1. What is the IRS' most recent estimate of the fiscal year 1990 budgetary shortfall? What is IRS' most recent estimate of the revenue loss associated with the budgetary shortfall? What program adjustments has IRS made due to the shortfall in funding?

The budgetary shortfall in FY 1990 has caused the IRS to reduce spending for supporting services and information systems and to limit hiring to key job occupations and specialties. The primary external events, which necessitated cutbacks, included sequestration ($46 million), the statutory requirements to cover

this year's 3.6 percent pay raise ($103 million), increases to government's share of employee benefits for retirement ($40 million), and health insurance and medicare ($34 million). The necessity to cover these shortfalls resulted in program reductions and hiring freezes that will result in a loss of $350 million in collected revenue for 1990.

Internal actions have caused funding cutbacks due to the need to cover employee promotions and upgrades that we believed were important to remain competitive, advancement of trainees, and employee within grade increases. A realignment of resources was also necessary to cover additional needs in the tax forms distribution program, process backlogs in currency transaction reports, increase internal audit coverage, cover electronic filling resource shortages and restore A-76 cuts.

For fiscal year 1990, IRS has put in place a strategy for financial control and monitoring. Steps were taken to implement a freeze on hiring, reassignments, and promotions. Increased emphasis was placed on position management and additional controls are being placed on ADP expenditures. Training expenditures have been severely restricted. IRS has delayed start-up of the FY 1990 revenue initiatives. The processing of tax returns and the issuing of timely refunds will not be affected.

2. For which areas within the IRS has the two year hiring freeze caused fiscal year 1990 staffing levels to drop below fiscal year 1988 levels? How has the hiring freeze affected the ability of current IRS employees to move up within the Service? How has the freeze affected employee attrition?

The hiring freeze has caused reductions in the management services and enforcement programs within the IRS. A restriction on competitive promotions was placed on most areas of the Service and stipulated that only one out of three vacancies could be filled. Prior agreements which existed on advancement of trainees were honored. The Service did not track the impact of the freeze alone on overall attrition figures during this period.

3. Are the following examples of cutbacks in IRS operations and service accurate: examination staffing levels at service centers are only at 65% of previous years; service centers can no longer work alternative minimum tax cases; self-employment taxes can not be examined even though they yield around $1,500 for less than an half hours work; the underreporter program has been cut this year (on top of last year's cut of 469 positions); IRS training programs no longer include a refresher course for tax examiners on recent tax law changes (training was also cut last year, so examiners may have gone two years without an update); cutbacks in travel have caused IRS district offices to select employee plans to examine based upon the location of

the taxpayer (determined by zip code) rather than the potential revenue yield; the IRS is paying rent for space on the West Coast that it cannot move into because the office cannot afford the cost of moving and hooking up the computers; the staff in the automated collection system has been cut; taxpayers are twice as likely to get a busy signal when calling the IRS for assistance than an answer; and, millions of affected taxpayers did not receive a supplemental mailing from IRS on the repeal of the Supplemental Medicare premium? Are these cutbacks due to budget shortfalls?

In FY 1990, Examination has planned 3,535 staffyears for service center operations which is approximately 96 percent of the 3,657 staffyears realized by the service centers in FY 1989. Currently, we anticipate realizing 100 percent of the planned staffyears in our service center operations.

Service centers have continued to work Alternative Minimum Tax and Self-employment tax cases. Furthermore, self-employment tax case are being examined close to FY 1989 levels at the service centers. The number of returns requiring an Alternative Minimum Tax computation has declined since the passage of the Tax Reform Act of 1986 with the changes to capital gains and other preference items.

The Tax Year 1988 Underreporter Program, which starts in FY 1990, will not be cut this year. It will involve 9.2 million in discrepant returns to be resolved compared to 6.2 million of the previous year program which was reduced by budget cuts in FY 1989.

In FY 1989, Continuing Professional Education (CPE) was conducted only to a limited extent. In FY 1990, CPE will be delivered at low or no cost. As alternatives to formal training, we are using innovative way such as workshops and group meetings dealing with technical and procedural issues.

Reductions in travel funds have, in fact, caused EP/EO key district offices to be mindful of the geographic location of employee benefit plans and exempt organizations being selected for examination. Travel reductions have dictated an increase in the percentage of examinations conducted using office audit and correspondence techniques. It should be understood that revenue yield is seldom the primary priority when selecting returns for examination. The basic purpose for conducting such examinations is to protect the benefits of the plans participants by ensuring that the plans are operating in compliance with a wide variety of legislated requirements as well as to regulate the operating compliance of organizations with the statutory requirements for maintaining tax exempt status.

The statement that "the IRS is paying rent for space on the West Coast that it cannot move into because the office cannot afford

the cost of moving and hooking up the computers" is not correct. The space in question is apparently that located at 450 Golden Gate, San Francisco, California -- about 15,000 square feet. The District Headquarters is being refurbished in order to remove asbestos. In the process, a number of small blocks of space (about 7) were vacated. In addition, about 4,000 square feet of space was vacated when a shelter processing unit was disbanded. Negotiations have been held with GSA to turn back this space, but GSA is unwilling to do so because it is in scattered locations. When refurbishing is complete, they are willing to realign space and take back the vacant space.

Busy signals are higher this year because we had to reduce the level of service due to the actions we took in order to meet the demands of pay absorption, sequestration, and increased labor costs. Since we have less staffing and telephone lines than last year, callers more frequently receive busy signals. Nevertheless, for the entire filing period, our sites answered 99.0 percent of the calls they were scheduled to answer. Also, taxpayers who responded to our survey of accessibility stated they reached an assistor 58.3 percent of the time on the first attempt and 73.8 percent of the time within two call attempts. Overall, IRS answered 17.5 million calls and recorded 32.6 million busy signals for the filing period.

IV. TAX SYSTEM MODERNIZATION (TSM):

1. Is TSM a high priority with the IRS? When do you think that TSM will be completed? What will the total price be? Do you expect the master plan to be completed on time, in September of this year?

TSM probably has the highest priority of any program in the IRS. Extensive briefings have been held for the Commissioner and top IRS management to elicit their input and support for Tax Systems Modernization. The Commissioner has stated his strong support for TSM in every Congressional hearing this year.

To date, we have only estimated the one-time cost of implementing TSM in 1998. That preliminary cost is $5.6 billion. Costs of transitioning from our current system to the new systems envisioned in TSM have not been completed. We will be presenting a full cost-benefit analysis as part of the Design Master Plan.

We are currently expecting to meet the September 1990 completion date for the Design Master Plan.

2. Will TSM be as dependent on paper documents as the present system is? What will replace paper? What is the status of the system ("input processing") which will convert paper documents to electronic images?

In a more modern environment, the IRS will not be as dependent on paper documents as it is today. The Integrated Input Processing System encompasses the receipt of returns and information documents as well as remittances. However, the IRS will continue to need the capability to process significant amounts of paper. The Document Processing System (DPS) allows the IRS to transfer the information on paper returns to electronic images, virtually eliminating the need to retain and store the paper documents.

The Request for Proposals (RFP) for the input system is currently being prepared. The RFP will be released in FY 1991.

3. After implementation of TSM, will the IRS still ship tax information via computer tape to the Martinsburg Computing Center? Will computer systems in the various IRS offices be able to communicate electronically with Martinsburg?

The concept of operations of the TSM is to eliminate the use of computer tapes as a means to transfer data between the service centers and the Martinsburg Computing Center. The IRS plans to use communications networks to electronically transfer data between various IRS sites and offices allowing IRS offices to communicate electronically with Martinsburg, Detroit, and the ten service centers.

4. Your most recent analysis shows that the mainframe computer in the largest service centers should have enough capacity to support processing through 1992. During the 1991, what are you going to do to ensure against capacity shortages and operational disruptions after 1992? Do you have a specific schedule with dates and milestones for implementing initiatives to ensure sufficient computer capacity?

We are planning to implement several initiatives to ensure against Service Center Replacement System (SCRS) capacity shortages after 1992. These are summarized below.

(1) An improved method of saving the data bases for backup and recovery purposes will be implemented in the fall of 1990. This will result in a 10 percent improvement in the time it takes to process the SCRS weekend workload.

(2) An improved method of accessing the major SCRS data base by January 1992. This will result in a 20 percent improvement in the time it takes to process the SCRS weekend workload.

(3) This year we have implemented the capability to process the SCRS real time workload on both SCRS systems located in each service center. This has resulted in a 20 percent reduction in the critical SCRS real time workload.

(4) A plan has been developed, and approved by the Senior Deputy Commissioner, to more evenly distribute the workload among the service

centers. SCRS workload and performance will be closely monitored to identify when this plan needs to be implemented. This plan requires 13 months lead time before implementation. When implemented, it will provide 1 to 2 years of additional capacity at the largest service center (currently the Fresno Service Center).

(5) We have identified, but have not yet tested, several initiatives to extend real time capacity. These include optimization of systems software, optimization of applications software, and moving some processing from the mainframes computers to the work stations. While we may not achieve the same results in real time optimization, we have been able to achieve an improvement of more than 70 percent through our optimization efforts.

5. If you experience delays with the Tax Systems Modernization projects, how long do you believe the current systems will be able to support processing operations before they experience capacity or serious reliability problems?

We believe that the current Service Center Replacement System has sufficient capacity to support processing operations through at least 1994. Additionally, we are in the process of negotiating a contract for hardware maintenance of these systems through 1995.

ATTACHMENT A

PROGRAM ANALYSIS SYSTEM (PAS)-ERROR RESOLUTION SYSTEM (IMF)

PERIOD: (4/26/90-5/2/90)		TOP FIVE SOURCES OF ERRORS	PER%	CUM%
RETURNS REVIEWED:	2569	1. TAXPAYER	58.5%	58.8%
ERRORS CODED:	5559	2. CODE & EDIT	16.7%	16.5%
CUM: (1/24/90-5/2/90)		3. DATA CONVERSION	14.2%	14.8%
RETURNS REVIEWED:	30555	4. CONSISTENCY CHECK	7.1%	6.2%
ERRORS CODED:	59148	5. ERROR CORRECTION	3.4%	3.4%

TOP SERVICE CENTER COMPUTER-IDENTIFIED ERRORS	PER	CUM
1. CODE & EDIT DIDN'T EDIT RETURN PROCESSING CODE T	90	733
2. DATA CONVERSION DIDN'T ENTER DEPENDENCY STATUS INDICATOR	42	656
3. CODE & EDIT DIDN'T EDIT DEPENDENCY TIN CODE	38	604
4. DATA CONVERSION ENTERED INCORRECT REFUND AMOUNT	35	389
5. CODE & EDIT DIDN'T EDIT ZIP CODE	33	363
6. CODE & EDIT DIDN'T EDIT EXEMPTIONS-CHILDREN LIVING W/TP	30	289
7. CODE & EDIT DIDN'T EDIT FILING STATUS CODE	29	451
8. CODE & EDIT DIDN'T EDIT COMPUTER CONDITION CODE	27	313
9. CODE & EDIT DIDN'T EDIT EXEMPTIONS FOR OTHER DEPENDENTS	23	261
10. CODE & EDIT DIDN'T CODE NON CASH CODE ON SCHEDULE A	20	109

ATTACHMENT B

Internal Revenue Service
Budget Chronology
FY 1981 - FY 1991
(Amounts in Millions)

	FY 1981		FY 1982		FY 1983		FY 1984		FY 1985	
	FTE	Amount	FTE	Amount	FTE	Amount	FTE	Amount	FTE	Amount
Request to Treasury	95,524	$2,494.6	101,366	$2,750.2	92,799	$2,879.3	97,535	$3,556.6	95,463	$3,748.9
Request to OMB	93,425	$2,363.9	93,205	$2,541.6	85,315	$2,760.9	89,504	$3,124.4	92,792	$3,609.9
Request to Congress	89,587	$2,385.1	88,000	$2,565.6	88,673	$2,917.2	91,761	$3,291.6	88,379	$3,531.9
Congressional Allowance	89,597	$2,357.5	84,358	$2,465.6	90,364	$2,948.2	89,282	$3,264.8	88,506	$3,511.2
Request for Supplemental Resources	87,652	$2,479.2	85,363	$2,589.0	90,364	$3,043.0	89,282	$3,325.6	87,743	$3,541.6
Final Congressional Allowance	86,156	$2,479.7	82,857	$2,671.9	83,603	$3,043.0	87,635	$3,325.6	92,259	$3,574.6
Actual Level Realized	84,695	$2,465.5	81,452	$2,626.3	83,603	$2,968.5	87,635	$3,279.1	92,259	$3,601.0

	FY 1986		FY 1987		FY 1988		FY 1989		FY 1990	
	FTE	Amount	FTE	Amount	FTE	Amount	FTE	Amount	FTE	Amount
Request to Treasury	93,240	$3,897.9	98,092	$4,292.3	117,666	$5,322.3	127,103	$6,170.7	128,422	$6,805.1
Request to OMB	88,259	$3,647.6	95,369	$4,120.2	111,627	$4,955.0	124,470	$5,818.8	118,707	$5,708.1
Request to Congress	86,489	$3,511.2	95,084	$4,097.8	110,661	$5,071.9	113,811	$5,299.7	115,110	$5,484.0
Budget Amendment	!								115,110	$5,542.5
Congressional Allowance	86,774	$3,642.8	100,266	$4,247.8	112,161	$5,058.9	113,058	$5,194.9	115,110	$5,549.9
Request for Supplemental Resources	93,724	$3,826.1	101,198	$4,447.8						
Final Congressional Allowance	95,880	$3,826.1	101,198	$4,444.7	112,161	$5,058.9	113,058	$5,194.9	115,110	$5,549.9
Actual Level Realized	95,880	$3,842.0	102,189	$4,335.1	114,875	$5,025.0	114,758	$5,194.7	Pending	

	FY 1991 FTE	Amount
Request to Treasury	119,842	$6,370.4
Request to OMB	120,440	$6,012.9
Request to Congress	118,759	$6,135.0
Congressional Allowance	Pending	
Request for Supplemental Resources		
Final Congressional Allowance		
Actual Level Realized		

ATTACHMENT C

INTERNAL REVENUE SERVICE

	FY 1978		FY 1979		FY 1980		FY 1981		FY 1982		FY 1983	
	FTE	$(000)	FTE	$(000)	FTE	$(000)	FTE	$(000)	FTE	$(000)	FTE	$(000)
Returns Processing	24,845	421,878	24,743	447,656	24,476	486,338	22,924	494,214	19,510	572,934	16,982	468,362
ADP & Information Technology	747	34,969	764	33,721	929	37,665	960	39,236	1,013	70,477	1,172	150,129
Executive Direction	129	4,941	138	5,689	142	6,279	143	6,922	134	7,268	119	8,883
Statistics of Income	613	13,219	580	12,694	610	14,253	645	16,766	547	14,859	452	14,894
Examinations	27,385	686,209	27,455	727,021	28,104	793,425	26,908	837,359	27,069	841,929	26,621	930,430
Appeals & Tax Litigation	2,614	74,966	2,471	76,390	2,719	89,419	2,716	95,773	2,727	101,080	2,940	122,169
Employee Plans	1,577	40,698	1,463	40,772	1,404	42,289	1,313	43,188	1,216	41,310	1,271	47,567
Exempt Organizations	910	23,597	897	25,096	887	27,626	839	27,680	778	26,853	852	33,922
Tax Fraud Investigation	4,356	125,169	4,348	133,684	4,395	145,245	4,320	158,245	4,153	155,644	4,029	167,457
Delinquent Returns	2,544	59,334	2,834	69,164	2,287	60,178	3,613	97,152	3,808	105,723	3,488	104,245
Accounts Receivable	8,055	207,466	8,916	218,990	9,402	247,544	9,662	262,059	10,775	301,180	13,683	402,849
Taxpayer Service	4,920	121,435	4,729	117,824	4,977	129,085	4,676	137,016	3,630	124,961	4,198	171,212
Enforcement Lit. & Technical Rulings	1,563	43,396	1,580	48,065	1,564	52,028	1,555	54,469	1,544	61,422	1,591	64,090
Tax Forms & Publications	513	64,017	540	84,440	569	81,488	528	86,348	543	98,339	413	69,941
Information Returns Program	1,773	25,616	2,702	58,328	2,941	50,784	3,345	89,481	3,532	84,392	3,416	114,488
Internal Audit	538	15,219	556	16,632	575	18,193	548	19,562	473	17,966	440	19,112
Research Initiative	0	0	0	0	0	0	0	0	0	0	0	0
Management Services	0	0	0	0	0	0	0	0	0	0	2,016	79,756
International	0	0	0	0	0	0	0	0	0	0	0	0
SERVICE TOTAL	83,882	1,962,129	84,707	2,116,166	85,981	2,280,839	84,695	2,465,470	81,452	2,626,337	83,693	2,960,526

INTERNAL REVENUE SERVICE

	FY 1984		FY 1985		FY 1986		FY 1987		FY 1988		FY 1989	
	FTE	$(000)	FTE	$(000)	FTE	$(000)	FTE	$(000)	FTE	$(000)	FTE	$(000)
Returns Processing	15,628	540,958	18,608	565,018	22,782	685,444	23,672	779,098	25,253	856,877	24,371	816,985
ADP & Information Technology	4,151	293,198	4,821	314,110	4,740	375,738	5,769	411,787	6,921	774,368	7,952	891,564
Executive Direction	115	6,352	126	6,857	123	6,646	119	8,330	129	8,043	115	8,235
Statistics of Income	634	20,238	419	19,874	400	14,065	414	15,904	415	15,397	504	21,061
Examinations	27,060	989,479	28,011	1,076,273	27,423	1,086,693	29,919	1,245,158	32,246	1,288,941	31,190	1,319,353
Appeals & Tax Litigation	3,473	149,273	3,627	165,862	3,561	166,824	3,953	187,707	4,780	231,415	5,222	232,924
Employee Plans	1,523	56,599	1,525	61,133	1,484	59,915	1,641	68,584	1,798	75,979	1,947	83,655
Exempt Organizations	907	33,758	875	33,200	866	34,819	831	34,677	905	38,368	888	33,902
Tax Fraud Investigation	4,417	201,535	4,602	216,664	4,392	218,983	4,516	241,536	4,783	252,942	4,523	239,877
Delinquent Returns	3,424	107,425	3,206	109,732	3,013	105,964	2,663	99,676	3,291	121,715	2,619	100,916
Accounts Receivable	14,490	456,566	13,705	469,728	13,069	460,287	13,823	517,838	15,986	593,859	16,632	669,164
Taxpayer Service	4,176	139,507	4,243	158,443	5,356	197,005	5,789	231,740	7,867	254,980	6,603	238,833
Enforcement Lit. & Technical Rulings	1,519	67,510	1,420	67,504	1,339	67,364	1,335	65,276	1,397	68,295	1,390	69,786
Tax Forms & Publications	564	19,526	567	113,946	610	125,383	324	143,956	332	173,306	274	150,804
Information Returns Program	3,598	117,852	4,427	135,074	4,727	145,301	5,259	178,241	7,029	236,170	7,150	225,419
Internal Audit	458	15,690	468	20,168	458	25,022	478	21,816	0	0	0	0
Research Initiative	0	0	125	365	93	3041	101	4241	100	4,062	101	10,264
Management Services	1,498	63,601	1,484	67,902	1,444	63,489	896	46,504	914	40,823	789	42,947
International	0	0	0	0	0	0	687	33,036	729	33,836	788	39,191
SERVICE TOTAL	87,635	3,279,067	92,259	3,600,953	95,880	3,841,983	102,189	4,335,105	114,875	5,069,376	113,058	5,194,880

INTERNAL REVENUE SERVICE

	FY 1990		FY 1991	
	FTE	$(000)	FTE	$(000)
Returns Processing	25,583	1,019,524	25,718	1,094,072
Information Systems	7,513	832,752	8,068	993,927
Executive Direction	121	8,836	110	9,786
Statistics of Income	544	19,265	544	20,148
Examinations	31,282	1,423,693	32,325	1,597,004
Appeals	2,920	171,472	3,012	187,659
Employee Plans	1,832	84,646	1,810	88,264
Exempt Organizations	859	39,681	840	41,045
Tax Fraud & Financial Invest.	4,323	236,872	4,387	261,663
Delinquent Returns	3,276	127,392	3,495	146,947
Accounts Receivable	17,179	686,232	18,316	786,763
Taxpayer Service	7,592	317,708	7,483	330,297
Enforcement Lit. & Technical	1,027	53,237	1,031	56,748
Document Matching Program	5,387	180,778	5,766	199,379
Inspection	1,308	60,630	1,433	71,881
Management Services	820	51,522	792	54,495
International	851	49785	900	55588
Tax Litigation	2,387	117,395	2,292	121,110
Currency Transaction Report	368	17,942	389	18,226
SERVICE TOTAL	115,892	5,490,762	118,750	6,135,980

ATTACHMENT D

Range of Estimates of Legal-Sector Income Tax Voluntary Compliance Rates[1], Selected Tax Years, 1981-1992

Tax Year	Total		Individual Income Tax		Corporate Income Tax	
1981	81.4	*to* 82.8	81.6	*to* 82.0	80.6	*to* 87.0
1982	81.7	82.9	81.8	82.2	80.8	87.1
1984	80.1	81.6	80.0	80.4	80.6	87.2
1986	79.5	81.0	79.2	79.7	81.1	87.7
1987	81.7	83.6	81.8	82.3	81.3	88.1
1988	82.0	84.0	82.3	82.7	81.2	88.1
1992	82.7	84.6	83.1	83.6	81.1	88.1

[1] The results of examinations of tax returns are used in estimating several categories of noncompliance. Where these results are used, the lower estimates of the voluntary compliance rate are based on the amounts of additional tax *recommended* by IRS examiners, and the higher estimates of the VCR are based on the amounts of tax ultimately *assessed* after all appeals and litigation.

Our estimates of the Tax Year 1987 gross legal-sector income tax gap range from $82.5 billion to $94.2 billion. A one-percent change in the voluntary compliance rate for that year would have resulted in a corresponding change in the gross tax gap of about $5 billion.

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

DEPUTY COMMISSIONER

MAY 24 1990

The Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

As you are well aware, this fiscal year has been a challenging one for the Internal Revenue Service. We have been operating under extremely stringent controls which have been difficult on our people. It has also affected all IRS programs, including those producing direct enforcement revenue. Start up of most FY 1990 revenue initiatives has had to be delayed. We have recently completed an assessment of the Service's financial condition through the second quarter of FY 1990. I want to share with you the more positive results of that review.

A small measure of flexibility now exists due to the actions we took (including hiring and promotion freezes) and the support and understanding we have received from the Administration and the Congress. We have released the promotion and clerical hiring restrictions on all functions in place since December. As resources become available, we are moving to increase post-filing season Taxpayer Service answering capability to more responsive levels and to bring back up reductions that were made last fall to the underreporter case program.

The combined impact of the sequester of the FY 1990 budget ($46.2 million) and absorption of the January 1990 pay raise ($103 million) have taken their toll. Relaxation of controls will allow us to focus our activities more in the most critical areas. Through the second quarter, we have used 48.5% of our staff year levels and are projecting to finish the year within our availability.

The Honorable J. J. Pickle

Along with Commissioner Goldberg and the rest of the Service, I appreciate your continued support for the Internal Revenue Service's budget and will keep you informed of any new developments to our budget as the fiscal year proceeds. If we can achieve the levels contained in the President's FY 1991 Budget proposals for the IRS, we can build on these actions we are able to take now and further improve our service for the American public.

Sincerely,

John D. Johnson
Deputy Commissioner (Planning and Resources)/Chief Financial Officer

Chairman PICKLE. Now, we'll ask Jennie Stathis and others representing the General Accounting Office to take a position at the witness table.

Jennie Stathis, Howard Rhile, those two.

I know you have waited patiently here. We thank you for that.

We are glad to have you again. And if you will please proceed, we will be glad to receive your testimony.

STATEMENT OF JENNIE S. STATHIS, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY DAVID J. ATTIANESE, ASSISTANT DIRECTOR, AND ROBERT P. GLICK, ASSIGNMENT MANAGER, GENERAL GOVERNMENT DIVISION

Ms. STATHIS. We are pleased to be here this morning, Mr. Chairman.

On my left is Dave Attianese, our Assistant Director who does the work each year on the budget and the filing season. And to his left is Bob Glick who is our Assignment Manager in the taxpayer service area.

I would like to read a summary statement which I believe you have a copy of, and submit our full statement, which is quite lengthy, for the record.

Chairman PICKLE. Well, if you'll wait just a minute. I do have your full statement. I don't know that I have your summary statement. Just a minute.

Is this the summary statement, this 50-page document, is that your summary statement? [Laughter.]

You're going to follow the summary statement.

Ms. STATHIS. That's right.

Chairman PICKLE. I have it now. Thank you.

Ms. STATHIS. We do make five points in the testimony today.

The first one deals with taxpayer service. IRS has improved the accuracy of its telephone service. This year, IRS assisters have responded accurately to 78 percent of our tax law questions, compared to 66 percent for the same questions last year.

Taxpayers are having more difficulty reaching an IRS assister. This year, IRS is answering one out of three calls. Last year, it answered almost two out of three.

Taxpayers should be finding it easier to obtain tax forms and publications this year. IRS is doing a better job of stocking its walk-in sites and filling phone and mail orders. Taxpayers who want to order materials by phone, however, are probably having more difficulty reaching IRS.

Except for a few problems that have delayed some refunds, returns processing has gone smoothly this year. Service center inventories are within what IRS considers manageable limits. And the percentage of returns with errors is lower than last year.

Because of funding shortfalls in fiscal years 1989 and 1990, IRS implemented a hiring freeze, curtailed promotions, cut back training, travel and other support services, and reduced various compliance programs.

The administration has estimated that those decisions would reduce revenues by about $700 million over 2 years. Prospects for a more stable fiscal environment in 1991 are encouraging. The budget requested is almost 12 percent higher, and IRS has improved its controls over spending. But such factors as having to fund the various pay proposals included in the President's budget, if they should be implemented, and the potential for another sequestration could alter those prospects.

IRS' budget includes several initiatives that the administration has estimated will raise about $3 billion in additional revenues. The initiatives that call for additional enforcement staff will, in effect, only serve to replace staff that IRS lost in the last year and a half. While we generally agree with the objectives of the other initiatives, which call for redirecting the existing staff, we are not convinced that they are achievable quickly enough to produce the promised revenues in 1991.

In telephone assistance, in addition to our own test calls, we monitored test calls made by IRS. Given the consistency of our results, we believe that the accuracy rates reported by IRS are reliable. Those rates also show that accuracy has improved.

We believe several factors contributed to the improved accuracy this year: increased managerial emphasis and involvement; a more stable and experienced work force; an increased emphasis on probing to obtain all of the facts needed about a taxpayer's situation.

Another IRS effort to improve telephone performance is the taxpayer service expert assistance system. This automated system contains information on about 100 tax law knowledge bases. It is designed so that an assister can lead the taxpayer through a series of questions and reach the answer.

We believe the expert system holds promise in improving telephone service in the future. The accuracy rates so far are just average, but it is early in the system's development, so that these results should be used to improve the design and use of the system.

While taxpayers may be having less trouble getting correct answers, they are having more trouble reaching IRS. As of March 17, IRS had received about 32 million calls and answered about 11 million of them; for a 34-percent answer rate.

Those who did not reach an assister received busy signals or were put on hold and hung up before IRS took their calls. Taxpayers were much more successful reaching IRS during a comparable period last year. Then IRS answered about 12 million of 19 million calls; a 61-percent answer rate.

In terms of forms, IRS has made several changes this year to improve their availability. Those changes appear successful. We visited 13 walk-in sites, and we checked on the availability of 82 forms and publications that all sites are required to stock.

One site was missing eight items; two sites were missing six items; and the other 10 sites were missing five items or less.

That compares favorably with last year, when 15 of 35 sites were missing 10 or more items.

Taxpayers can also order tax materials by mail or phone. This year, so far, we have received 87 percent of the items we ordered and an even higher percentage of those items that are more commonly used.

IRS appears also to be doing a good job processing returns. More returns have been received and even more processed. Consequently, IRS had issued about 17 percent more refunds than last year. Although there had been some delays in issuing refunds, they have apparently affected a relatively small number of taxpayers.

Service center inventories fluctuate weekly, making it difficult to judge how manageable they are. But most inventories at March 9th were lower than at the same time last year. The two inventories running slightly ahead of last year's pace, were adjustments/correspondence, and unidentified remittances.

Both inventories include items not previously counted. And both are within IRS' manageability limits. The percentage of returns with errors declined again this year; 14 percent, down from 16 percent in 1989, and 18 percent in 1988.

Predominant taxpayer errors are mistakes in calculating or claiming the earned income credit and determining the correct standard deduction.

This year, IRS is dealing with a budget shortfall of about $465 million. IRS continued a hiring freeze, begun in fiscal year 1989; cut expenditures for training, travel, equipment and supplies; limited promotions; and reduced funds for information systems other than tax system modernization.

Because of the hiring freeze, IRS has not implemented seven of the nine revenue initiatives authorized for this year. IRS also adjusted some programs to cut costs, such as reducing the level of taxpayer service.

Field offices told us that they have eliminated all but the most essential training. Some said that employees are not getting industry-specific, computer and other technical training necessary to do their jobs effectively.

We were also told of positions left vacant because of insufficient money to relocate employees.

Enforcement activities appear to have suffered most from the cutbacks. For example, service centers said that they are doing less work in the document matching program to identify underreported income and that they are doing fewer correspondence audits.

Two districts said that they have fewer higher graded staff to do complex enforcement cases. And an automated collection site reported that 22 vacant tax examiner positions and three vacant group manager positions caused a significant increase in older cases in the site's inventory.

IRS' proposed budget for fiscal year 1991 totals $6.1 billion—an increase of about $635 million.

For several reasons, this budget should provide a more stable fiscal environment for IRS. It includes funding for half the expected pay raise next year; it reflects the impact of the other unfunded half; it also reflects a reestimation of baseline salary and benefit costs. IRS has also improved its controls over spending.

A major feature of the 1991 budget is the revenue initiatives and management reform that were discussed previously and that are expected to raise $3 billion.

Their objectives seem reasonable to us. But IRS' success in achieving them will depend on its ability to implement some rather ambitious plans.

We believe IRS has a reasonable chance of implementing the revenue initiatives, which are expected to raise a half a billion dollars. We are not convinced that IRS can implement the management reforms quickly enough to produce the promised revenue. These reforms are predicated upon pervasive changes to the way that IRS now does business. Taken together, they will pose a significant challenge.

Another issue with respect to the initiatives is determining a baseline against which to measure accomplishments. Enforcement staff levels have eroded to the point that increases may only backfill vacancies.

For example, IRS had about 17,300 revenue agents at the end of fiscal year 1988. In February 1990, the number had declined to about 15,900. Even with the increase in the 1991 budget, revenue agents will still number less than 17,300.

That concludes my summary. We will be pleased to respond to questions after my colleague gives his statement.

[The statement of Ms. Stathis follows:]

STATEMENT OF JENNIE S. STATHIS, DIRECTOR
TAX POLICY AND ADMINISTRATION ISSUES, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its inquiry into the status of the 1990 filing season, IRS' current fiscal condition, and IRS' budget request for fiscal year 1991. My testimony makes the following points:

-- IRS has improved the accuracy of its telephone service. This year, IRS assistors have responded accurately to 78 percent of our tax law questions, compared to 66 percent for the same questions last year. But taxpayers are having more difficulty reaching an IRS assistor. This year IRS is answering 1 out of 3 calls; last year it answered almost 2 of 3.

-- Taxpayers should be finding it easier to obtain tax forms and publications this year compared to last. IRS is doing a better job of stocking its walk-in sites and filling phone and mail orders. Taxpayers who want to order materials by phone, however, are probably having more difficulty reaching IRS than in 1989.

-- Except for a few problems that have delayed some refunds, returns processing has gone smoothly this year. Service center inventories are within what IRS considers manageable limits and the percentage of returns with taxpayer errors or IRS processing errors is lower than last year.

-- Because of funding shortfalls in fiscal years 1989 and 1990, IRS implemented a hiring freeze; curtailed promotions; cut back training, travel, and other support services; and reduced various compliance programs. The administration estimated that those decisions would reduce revenues by $700 million over 2 years.

-- Prospects for a more stable fiscal environment in 1991 are encouraging. The budget requested is 12 percent higher and IRS has improved its controls over spending. But such factors as having to fund the various pay proposals included in the President's budget, if they should be implemented, and the potential for another sequestration, could alter those prospects.

-- IRS' budget includes several initiatives that the administration has estimated will raise about $3 billion in additional revenues. The initiatives that call for additional enforcement staff will, in effect, only serve to replace staff that IRS lost in the last year and a half due to a hiring freeze. While we generally agree with the objectives of the other initiatives, which call for redirecting existing staff, we are not convinced that they are achievable quickly enough to produce the promised revenues in fiscal year 1991.

TELEPHONE ASSISTANCE

IRS' telephone assistors are answering tax law questions more accurately than last year, but service availability has declined.

Between February 5 and March 16, 1990, we made test calls to 29 IRS call sites and scored 1,261 responses to 20 test questions. Assistors answered the questions correctly 78 percent of the time. Last year, assistors answered the same 20 questions correctly 66 percent of the time.

In addition, we monitored 245 test calls made by IRS between March 5 and 16. Our scores of those calls agreed with IRS' scores about 94 percent of the time. Given the consistency of these results, we believe that the accuracy rates reported by IRS

for each of the 2 weeks (76 percent and 79 percent, respectively) are reliable. Those rates show that accuracy has improved over last year, when the overall score from IRS' test was about 63 percent.

As the Subcommittee requested, we will continue to monitor IRS' test calls throughout the filing season and will provide the results for the hearing record.

Several factors have contributed to IRS' improved accuracy this year: (1) increased managerial emphasis and involvement; (2) a more stable and experienced workforce; and (3) increased emphasis on probing to obtain all the facts needed about a taxpayer's situation--a problem we identified in prior years' tests--as evidenced by the development and use of various assistor guides that identify probes and responses needed for various tax law questions.

IRS' national office developed a probe and response guide when it became evident during the design of last year's test that IRS lacked agreed upon standards that assistors should use when answering tax law inquiries. That guide is a good first step in providing assistors with acceptable response standards. IRS regions expanded and revised the guide in different ways so that various guides are now in use. Although similar in content, the guides differ in the way probes are stated and in the tax law subjects addressed. These differences could affect the accuracy of assistor responses from call site to call site. IRS should review the various guides, cull the most useful information from each, and incorporate it into the national guide. Once that is accomplished, IRS should include information on how to use the guide in next year's training programs. IRS agrees and plans to take steps along these lines.

Another IRS effort to improve telephone assistors' performance is the Taxpayer Service Expert Assistant System. This automated system, being tested at IRS' Boston call site, contains information on about 100 tax law "knowledge bases". The system is designed so that an assistor can lead the taxpayer through a series of questions, each dependent on the taxpayer's response to a prior question, and reach a system-provided answer.

We believe the Expert System holds promise in improving IRS' telephone service. Our test suggests a lower accuracy rate--72 percent at Boston compared to a 78 percent average at the other sites. In contrast, IRS' test results show that, after a bumpy start, Boston's accuracy rate is a little better than the national average. Similarly, Boston's rate of improvement thus far is in the mid-range compared to other sites. At this early stage in the system's development, these results can be used to improve the design and use of the system. IRS is evaluating the Expert System to decide on any changes or expansion to other locations; and we will continue to share with IRS any suggestions we have.

While taxpayers may be having less trouble getting correct answers to their questions, they are having more trouble reaching IRS.

-- As of March 17, 1990, taxpayers had called IRS about 31.5 million times and IRS had answered about 10.7 million of those calls, a 34 percent answer rate. Those who did not reach an assistor received busy signals or were put on hold and hung up before IRS took their calls. Taxpayers were much more successful reaching IRS during the comparable period last year, when IRS answered 11.8 million of 19.3 million calls, a 61 percent answer rate.

-- IRS also tracks the number of calls answered on a caller's first or second attempt--a measure that has also declined.

As of March 10, 1990, IRS had answered 73 percent of incoming calls on the caller's first or second attempt, compared to 90 percent in 1989.

Our test of IRS' telephone assistance also showed a decrease in accessibility. This year we reached an IRS assistor on the first attempt 55 percent of the time, compared to 69 percent last year and 76 percent in 1988.

IRS attributes its reduced accessibility to funding cutbacks and a higher than expected demand for toll-free service. Because of funding cutbacks, for example, IRS reduced the number of toll-free telephone lines from 4,622 in fiscal year 1989 to 4,411 in fiscal year 1990. IRS also estimates that staffing during peak workloads will total 4,732 employees, down from 5,095 employees in 1989. These reductions come in the face of taxpayer demand for toll-free service that, according to IRS estimates, is running about 7 percent higher than last year and 7 percent higher than IRS had projected for this year.

In past years, IRS has acted to meet increased demand by hiring additional temporary employees or by reassigning employees who have related duties. IRS officials told us they have opted not to adopt these measures this year so as not to compromise the accuracy of assistance by using lesser-trained staff. Ideally, we would expect IRS to maintain adequate levels of both accessibility and accuracy. Given IRS' recent fiscal problems, however, we believe its decisions were reasonable.

AVAILABILITY OF FORMS AND PUBLICATIONS

IRS made several changes this year in trying to improve the availability of tax materials. Those changes appear successful.

Last year we reported that IRS needed to improve distribution of tax materials to the public. Tax materials were not always available at the IRS walk-in sites we visited, especially early in the filing season, and some sites were not stocking certain forms and publications that they were required to stock. Also, we did not receive about 20 percent of the items we ordered by phone and mail from IRS' three distribution centers, and we often did not receive an explanation when an item we had ordered was not included in the shipment IRS sent us.

Our spot checks of IRS walk-in sites this year indicate that forms and publications are more available. Between January 22 and February 26, 1990, we visited 13 walk-in sites in 5 states to check on the availability of 82 forms and publications that all walk-in sites are required to stock. One site was missing 8 items, 2 sites were missing 6 items, and the other 10 sites were missing 5 items or less. That compares favorably with last year when, during the same general time frame, we found 15 of 35 sites missing 10 or more of the 79 items that they were required to stock.

Of this year's 82 required items, 2 (Publication 553 on 1989 tax law changes and Publication 575 on pension and annuity income) were not available to any walk-in site until mid to late February. The delay in Publication 553 was due, in part, to legislation that was enacted late in 1989. According to IRS officials, both publications were also delayed because responsible staff were also working on the Taxpayer Service Expert Assistant System.

Taxpayers can also order tax materials by mail or phone from one of three IRS distribution centers. Between January 22 and February 23, 1990, we placed 77 random mail and phone orders. Each of our orders was for 4 items (as opposed to 10 items last year). The orders were randomly split into four groups: phone

orders of items randomly selected from IRS' list of 82 commonly ordered items, phone orders of items randomly selected from a list of 325 less commonly ordered items, and two groups of mail orders randomly selected from the same lists. As of March 9, we had received 266, or 87 percent, of the 307 ordered items.

IRS has done a better job this year explaining to taxpayers why items ordered by phone or mail are not included in the shipments received by the taxpayers; but there is still room for improvement. If an item is out of stock, for example, IRS is supposed to backorder the item and let the taxpayer know. Last year, IRS failed to provide an explanation for 61 percent of the items missing from our orders. In this year's test, 81 of the 307 items we ordered as of February 23 were not included in the initial shipments we received from IRS. In about 29 percent of those instances, we received no explanation.

We received 58 percent of our mail-ordered items and 86 percent of our phone-ordered items within the 14 days IRS tells taxpayers to expect delivery. This compares with the on-time rates of 58 percent for mail items and 84 percent for phone items that we found last year.

As was the case with taxpayers seeking answers to tax law questions, taxpayers attempting to order tax materials by phone are probably having more trouble reaching IRS this year. As of March 10, 1990, according to IRS' statistics, the distribution centers had answered about 46 percent of the calls on the caller's first attempt, compared to 66 percent for the same period last year.

RETURNS PROCESSING

Although there have been some delays in issuing taxpayer refunds, IRS appears to be doing a good job processing returns so far this year.

As of March 9, 1990, IRS had received 3.5 percent more returns than at the same time last year, but had processed 12.5 percent more. Consequently, IRS had issued about 21.5 million refunds, or 16.7 percent more than last year. A relatively small number of refunds have been delayed this year due to various problems.

Recently, for example, about 250,000 refunds, including about 53,000 to be issued through IRS' electronic filing program, were delayed about 2 weeks. The delay occurred because a courier failed to deliver tapes that were being transported between the Cincinnati Service Center and IRS' Martinsburg, West Virginia computer facility. A breakdown in controls allowed the nondelivery to go undetected for about 2 weeks.

As many as 170,000 additional refunds, including those on 31,000 electronically filed returns, were delayed about 1 week because tapes containing data from returns filed at the service center in Ogden, Utah could not be read by computers at the Martinsburg facility. IRS officials said that although Martinsburg received corrected backup tapes within 24 hours, refunds were delayed a week because Martinsburg processes refunds weekly and the refunds for that week had already been processed.

Another delay affecting much fewer taxpayers occurred because new IRS procedures to correct a 1989 processing problem were not properly implemented. Last year, refunds due spouses of previously-divorced taxpayers were delayed if the previously-divorced taxpayer was subject to the refund offset program. The entire refund on jointly-filed returns was erroneously frozen while refund offset action was taken. To prevent a recurrence of the problem this year, IRS planned to isolate these returns--which it calls injured spouse returns--during processing and determine the proper portion of the refund to offset.

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Unfortunately, refunds other than those relating to injured spouse returns were set aside and frozen this year. Until IRS reviews the returns in more detail, it will not know how many of the 13,000 refunds frozen under the injured spouse program through the first week of March were frozen erroneously. IRS issued new procedures that it believes, will prevent further errors. According to IRS officials, refunds for taxpayers affected by this problem will be delayed about 4 weeks.

IRS received considerable press coverage earlier this year when it announced that about 566,000 taxpayers received tax packages that contained envelopes addressed to the wrong IRS service center. The problem occurred because the vendor who printed the envelopes erred when matching taxpayer addresses with service center locations. IRS said that returns would be properly processed regardless of the center receiving the return and that this error should not delay any refunds. However, if a return is processed by a center other than the one that would normally handle the return, the taxpayer may not be able to determine the status of his or her refund through IRS' refund inquiry program.

Service center
inventory levels

Although service center inventories fluctuate weekly, making it difficult to assess their overall manageability, inventory levels as of March 9, 1990, appeared to be within IRS' manageability limits and were generally lower than at the same time last year. For example, the entity inventory, which involves cases that require IRS to update or correct taxpayer files for such things as name and address changes, was about 39 percent below last year's level. Likewise, the unpostables inventory, which involves transactions that must be corrected before they can be posted to taxpayers' accounts, was running about 16 percent below last year. As of March 9, two inventories were running slightly ahead of last year's pace, although they were both within IRS' manageability limits. The adjustments/correspondence inventory, which includes adjustments needing to be made to taxpayer accounts in response to taxpayer correspondence, had increased by about 7 percent, and the unidentified remittance inventory, which includes taxpayer payments that IRS must research in order to determine to which taxpayer or tax period the payment applies, had increased by about 13 percent.

One inventory that for several months had been well above the level IRS considers manageable was the adjustments/correspondence inventory at the Kansas City Service Center. One of IRS' criteria for manageability is that not more than 20 percent of the cases should be unresolved 45 days after receipt. Between June 1989 and February 1990, Kansas City's 45-day and older inventory was generally above 20 percent and rose as high as 34 percent--a condition service center officials attributed to staffing shortages due to IRS' financial condition. After staffing was increased and overtime authorized, Kansas City's 45-day and older inventory dropped below 20 percent for the week ended March 2, 1990, and stood at about 17 percent as of March 9.

Errors on filed returns

Continuing a recent trend, the percentage of returns with taxpayer errors or IRS processing errors is decreasing. IRS' cumulative statistics for the filing season through March 7, 1990, show that the number of returns with errors stood at about 14 percent, down from about 16 percent in 1989 and 18 percent in 1988.

IRS statistics show that taxpayers account for about 61 percent of the errors and that taxpayers are continuing to make the same types of errors as they have in the past. Predominant errors are mistakes in calculating or claiming the earned income credit

and determining the correct standard deduction. As in past years, IRS made changes in tax forms and instructions in an attempt to reduce errors in these areas. Although the overall error rate has declined, these areas continue to pose problems.

IRS' FISCAL YEAR 1991 BUDGET

For the past 2 fiscal years, IRS made several adjustments to its financial plan to deal with significant budgetary shortfalls--adjustments that led to curtailed service and reduced revenues. The most important question to be answered in assessing IRS' budget for fiscal year 1991 is whether it provides a base for stabilizing what has been an unstable fiscal environment. We believe that it does. Although various decisions could alter IRS' financial picture, we see enough differences between this year's budget and those of the past couple of years to warrant optimism. Even more encouraging is the fact that IRS has taken steps to strengthen its controls over budget execution--steps that should enable it to better manage its resources.

IRS' budget also includes several initiatives that are intended to increase revenues. The initiatives that call for additional enforcement staff will, in effect, only serve to replace staff that IRS lost in the last year and a half due to a hiring freeze. While we generally agree with the objectives of the other initiatives, which call for redirecting existing staff, we are not convinced that they are achievable quickly enough to produce the promised revenues in fiscal year 1991.

Funding shortfall in fiscal year 1990

As we reported last year, IRS took several steps to deal with a $360 million shortfall in fiscal year 1989. This year, IRS is dealing with a bigger shortfall of about $465 million. IRS attributed this year's shortfall to an unfunded pay increase, growth in salary and benefit costs, sequestration, a transfer of funds to support the Government's War on Drugs, and a decision to spend additional funds on various activities such as the distribution of forms and publications and the processing of currency transaction reports.

To cover the fiscal year 1990 shortfall, IRS continued the hiring freeze begun in fiscal year 1989; cut expenditures for training, travel, equipment, supplies, and other support services; limited promotions and position upgrades; and reduced funds for information systems other than Tax System Modernization. Because of the hiring freeze, IRS has not implemented seven of the nine revenue initiatives that Congress authorized as part of IRS' fiscal year 1990 budget. IRS also made some program adjustments in an attempt to cut costs, such as reducing its level of taxpayer service. Treasury's Office of Tax Analysis estimated that the decision to delay the fiscal year 1990 revenue initiatives and to freeze hiring will result in lost revenues totaling almost $700 million in fiscal years 1990 and 1991.

As additional funds have become available through reprogramming, IRS has selectively lifted the hiring freeze. When the results of IRS' mid-year financial review become available in early April, we will know more about the agency's ability to further ease hiring and spending restrictions and the effect on enforcement revenues.

We discussed the impact of IRS' fiscal problems with officials at IRS' National Office; Central, Midwest, and Western Regional Offices; Cincinnati, San Francisco, and St. Louis District Offices; Cincinnati, Fresno, and Kansas City Service Centers; and Indianapolis, Oakland, and St. Louis Automated Collection Sites.

Our inquiries showed that field offices have had to eliminate all but the most essential training. Some officials told us, for example, that employees are not getting industry-specific, computer, and other technical training necessary to do their jobs effectively. We were also told of positions that are going unfilled because of insufficient funds to relocate employees and of reductions that affected the use of space and equipment.

Field operations have also been affected by staffing cutbacks. As noted earlier, funding shortages have made it more difficult for taxpayers to get through to IRS with their tax law questions and contributed to the growth in Kansas City's older adjustments/correspondence cases. IRS' enforcement activities appear to have suffered most from the cutbacks.

For example, service center officials told us of cutbacks in various service center compliance programs including those that involve (1) the use of information returns to identify persons who have underreported their income and (2) the audit of simple issues through correspondence with the taxpayer. Also, enforcement officials at two district offices said they expect to do fewer complex cases because of a shortage of higher graded staff to do the work. And officials at one automated collection site reported that 22 vacant tax examiner positions and 3 vacant group manager positions caused a significant increase in the number of older cases in the site's inventory. Other offices complained that some professional staff are doing their own clerical work, allowing them less time to do their normal enforcement activities.

Attachment I contains a list of the various effects cited by field offices in discussing IRS' funding cutbacks.

Prospects for a more stable fiscal environment in fiscal year 1991

IRS' proposed budget for fiscal year 1991 totals $6.1 billion and provides for 118,759 average positions, an increase of about $635 million (11.6 percent) and 3,667 average positions (3.2 percent) over the authorized levels for fiscal year 1990. The $635 million increase is a net of various increases and decreases. The increases are (1) $377.7 million to maintain current operating levels and handle an anticipated workload growth in the processing of returns and the printing of forms; (2) $191.0 million to fund several initiatives directed at collecting additional tax revenues; (3) $146.2 million for information systems, including Tax System Modernization; and (4) $23.7 million for the War on Drugs and an expansion of Internal Audit coverage. The decreases involve (1) $58.2 million in program reductions needed to offset unfunded pay costs, (2) $22.2 million in anticipated savings, (3) $12.4 million transferred to the Department of Justice for the War on Drugs and to Treasury's Inspector General, and (4) $10.5 million in nonrecurring costs.

For several reasons, this budget would appear to provide the foundation for a more stable fiscal environment at IRS than has existed in the recent past.

IRS, like other federal agencies, was not allowed to include funds for the 1989 and 1990 general pay increases in its fiscal years 1989 and 1990 budget submissions. In contrast, IRS' 1991 budget submission includes funding for one-half of the expected 3.5 percent 1991 general pay raise. Also, unlike last year, the 1991 budget reflects the impact of unfunded pay costs--program reductions of $58.2 million and about 1,600 staff years. The administration estimates that the unfunded part of the pay raise will reduce revenues by $82 million in 1991 and by an additional $153 million in fiscal year 1992.

Part of the fiscal year 1989 and 1990 shortfalls were attributed to IRS underestimating its baseline salary and benefit costs. In response to that problem, IRS has reprogrammed its 1990 budget to ensure more adequate funding of baseline salary and benefit costs and has based its 1991 request on that corrected baseline. IRS officials believe that, barring unforeseen cost increases, the 1991 request will cover their anticipated on-board personnel costs. There also appears to be a heightened sensitivity in IRS regarding the need to consider the long-term implications of staffing and promotion decisions in terms of personnel and benefit costs. National office officials told us that a failure to adequately consider those implications had contributed to IRS' problems in 1989 and 1990.

IRS' fiscal stability should also be enhanced by improved controls over spending. IRS now has the budget execution module of its Automated Financial System on line, which enables financial plan managers, including the recently-appointed Chief Financial Officer, to better assess past and current spending trends, compare regional spending patterns, analyze specific expenditures, and project future spending requirements. That improved monitoring capability should contribute to better financial control and accountability Service-wide.

IRS' prospects for an improved fiscal condition in 1991 appear good, but several factors could alter that prognosis. The President's budget includes provisions for several pay-related reforms, including locality pay in three major cities, higher entry level salaries in grades 5 and 7, and hiring and retention bonuses. On the basis of our review last year of IRS' recruitment program, we believe that IRS would benefit from being able to offer higher pay. But IRS' budget does not include funds to cover any costs that might be incurred if these proposals are implemented. IRS' financial plan could also be affected by the anticipated postal rate increase, which is not provided for in the budget, and by a fiscal 1991 sequestration, should that occur.

IRS' fiscal year 1991 budget also includes some questionable savings. As in past years, the budget includes savings expected from studies done under OMB Circular A-76--savings that IRS has not realized in the past and will probably not realize in 1991. The budget also includes anticipated savings from IRS' conversion to the FTS-2000 telephone system--savings that IRS thinks may be overstated. To the extent these savings go unrealized, IRS will have to absorb the difference.

Revenue initiatives

A major feature of IRS' budget is the inclusion of several initiatives that are expected to raise $3 billion in tax revenues in fiscal year 1991 and about $10.0 billion through fiscal year 1995. Those initiatives fall into two main categories.

The first category provides more resources to allow IRS to (1) increase collections of additional taxes owed but not paid, (2) audit more tax returns and refund claims, (3) verify more taxpayer deductions and credits, and (4) hire contract instructors to train new revenue agents. IRS is asking for $191 million to implement these initiatives and expects them to produce $500 million in enforcement revenues in fiscal year 1991. The second category contains management initiatives that do not require additional resources but provide, instead, for a retargeting of existing resources. In these initiatives, IRS intends to (1) accelerate the closure of tax shelter cases, large audits, and large-dollar appeal cases; (2) audit more excise tax returns; and (3) do more actuarial examinations of small retirement plans. IRS expects this retargeting of resources to

generate $2.5 billion in additional tax revenues in fiscal year 1991.

The objectives of all these initiatives seem reasonable. IRS' success in achieving the objectives, however, and generating the expected revenues will depend on its ability to implement the action plans it has prepared for each of the initiatives. In the first category, revenue initiatives, we believe IRS has a reasonable chance of implementing its plans. IRS' action plan for the accounts receivable initiative, for example, includes a step that calls for deploying staff "in a manner that will maximize revenue collections".

With regard to the second category, management initiatives, we are not convinced that IRS can implement those action plans in the manner or time necessary to achieve its objectives and produce the expected revenues in fiscal year 1991. Our opinion is based primarily on the fact that these initiatives are predicated on pervasive changes to the way IRS now does business, which, taken together, can pose a significant challenge to IRS.

The Congressional Budget Office (CBO) expressed its views on the initiatives in a report issued on March 5, 1990. With respect to the first category of initiatives, CBO said that it agreed that the initiatives "could be effective in increasing revenues, but not as rapidly or as substantially as the Administration estimates." Regarding the proposed management initiatives, CBO said that "IRS has been unable to adequately document how [the reallocation of staff] would be successfully implemented in the field and how it would raise additional revenue."

In the past, IRS has been unable to track its progress in implementing such initiatives or to demonstrate success in generating the projected revenues. We understand that IRS is developing a tracking system to monitor implementation of the fiscal year 1991 revenue initiatives. One step that must be taken in developing such a system is to determine the baseline against which to measure accomplishments. In that regard, staffing levels in IRS' enforcement programs have eroded since inception of the hiring freeze in October 1988, to the point that increases called for in the 1991 budget may only serve to backfill some of that erosion--especially if the hiring freeze remains in effect for the rest of the fiscal year. After a major staffing increase authorized by Congress in fiscal years 1987 and 1988, for example, IRS had 17,323 revenue agents on board as of September 30, 1988. As of February 1990, after about 1 1/2 years of a hiring freeze, that number had decreased to 15,924. Even with the increase of revenue agent staff years called for in the 1991 budget, IRS will still be below the September 30, 1988, level.

We also have some specific concerns about individual initiatives. For example, while we agree in concept with the desirability of accelerating the closure of tax shelter cases, large audits, and large-dollar appeal cases, IRS should assure that is has controls in place so that pressures to close cases and collect dollars do not lead to inappropriate settlements. With regard to the proposed shift of resources to do more actuarial examinations of small retirement plans, IRS should ensure that it has adequate staffing to meet its other responsibilities in the exempt organization/employee plans area. And, while using contractors to train revenue agents may be a cost-effective decision, such a change needs to be adequately assessed before IRS implements it across the country. These concerns may be assuaged as we learn more about IRS' plans.

CONCLUSION

IRS has had to make some difficult decisions in the past 2 years to deal with funding shortfalls--decisions that have affected

IRS' ability to do its job. We believe that the budget for fiscal year 1991 lays a foundation for improving that fiscal environment. More importantly, it appears that the events of the past 2 years have heightened IRS' sensitivity to the need to better manage its resources and to maintain stricter accountability for the use of those resources. We are especially encouraged by the leadership we see being provided by IRS' Chief Financial Officer in bringing more direction and oversight to the budget execution process.

Despite its funding problems, IRS has generally been able to satisfactorily meet its varied returns processing and taxpayer service responsibilities during the filing season. Although the refund delays are troubling, they have apparently affected a relatively small number of taxpayers. We will continue to monitor that area during the rest of the filing season. We will also continue to monitor IRS' progress in answering taxpayers' tax law questions. We applaud the significant increase in the accuracy of answers being provided by IRS' assistors, but are somewhat troubled by the decreasing ability of taxpayers to get through to the assistors.

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That concludes my prepared statement. We will be happy to respond to any questions.

ATTACHMENT I

EFFECTS OF
IRS' FUNDING CUTBACKS

These effects were obtained through discussions with various IRS officials and were not independently verified. In many cases we were unable to get specific information to quantify the impact (in terms of lost revenues, for example).

Cutbacks in training, travel, and other support services.

. Because of a 50 percent reduction in the region's training budget, most outside training, all advanced technical training, and most cross-functional and management training that was not provided by December 31, 1989, will be eliminated. (Midwest Region)

. Cutbacks in training have affected specialists (such as people working in resources management and information systems) because those kinds of people need outside training. (St. Louis District)

. Funds are not available to train programmers in new computer languages. Without training, personnel cannot provide the kind of support needed to write, modify, and update computer programs. (St. Louis District)

. Other than a 1-day course on the Taxpayer Bill of Rights, Examination personnel have not been trained on 1987 and 1988 tax law changes. We were told that Examination personnel started working 1987 cases in the summer of 1989 and that training for the 1987 and 1988 tax law changes is scheduled for May 1990. (St. Louis District)

. Very little, if any, continuing professional education has been provided in the last 2 years for Examination and Automated Collection Site personnel. Only 2 or 3 of the 10 Examination employees who needed training in the insurance area received it. (Cincinnati District, Indianapolis Automated Collection Call Site)

. Positions could not be filled through internal transfers because of limited relocation money. (Midwest and Central Regions)

. The number of telephone lines in such activities as Examination and Collection was reduced from 1,200 to 900. District officials said that about half of the cut lines were probably not needed. (San Francisco District)

. The space allocated for a district office move was based on the expectation that it would be furnished with systems furniture. Because there is not enough money to buy all of that furniture, the new space will be inadequate to accommodate some staff. (St. Louis District)

. The district is renting about 15,000 square feet of office space at a cost of about $350,000 a year. Because of the hiring freeze, the district does not know how many people it will have to accommodate in the space and thus has not laid telephone lines and computer cables. In the meantime, the space remains vacant. (San Francisco District)

. Funds were not available to maintain the district's local area network. When the system failed, the district was able to purchase only 12 of the 36 machines needed to replace the old system. We were told that, as a result, the district's automation effort has gone backwards. Instead of pressing a key to use electronic mail, users now have to print a copy of the document, make copies, and address envelopes or hand carry the document. (St. Louis District)

Cutbacks in staffing

. We heard pervasive complaints about lack of support staff and the need for higher-graded employees to do clerical work.

. Staffing cuts caused the percent of overaged cases in the adjustments/correspondence inventory to rise to as high as 34.4--well above IRS' level of manageability. (Kansas City Service Center)

. The accessibility of IRS' toll-free telephone assistance has dropped this year compared to last. This year, for example, IRS is answering 1 out of 3 calls; last year, it answered almost 2 of 3. (Nationwide)

. Work in the Underreporters Program (whereby IRS identifies income underreported through matching of information documents with tax returns) was deferred. (Kansas City and Fresno Service Centers) A Fresno official estimated the revenue effect to be about $16.6 million in unrealized assessments.

. Work in the Substitute for Return Program (whereby IRS uses data on information returns to create income tax returns for nonfilers) was cut back. (Cincinnati, Kansas City, and Fresno Service Centers) Fresno had a backlog of about 200,000 cases which, we were told, would average about $5,000 in tax liability. A center official estimated the revenue effect of the shortfall in this program to be about $42 million in unrealized assessments. Kansas City had a backlog of about 65,000 cases which, we were told, would average about $5,000 in tax liability. We were told, also, that these cases could eventually be worked because there is no statute of limitations but that their deferral could reduce IRS' potential for collecting anything on these cases by making it more difficult for IRS to locate the taxpayers.

. The Service Center Correspondence Audit Program (whereby IRS audits simple issues through correspondence) was reduced about 20 to 25 percent. As a result, the center will work about 15,000 fewer cases this year. We were told that the average assessment for this type case is $1,500. (Kansas City Service Center)

. Tax examiners were moved from the Service Center Correspondence Audit Program to do clerical work in the Examination Support Unit. The clerical work in the Examination Support Unit involved processing paperwork related to tax shelters including the paperwork necessary to protect the statute of limitations on shelter cases. (Fresno Service Center)

. Because of limitations on what kinds of cases can be worked by employees at certain grade levels, the cutbacks in hiring and promotions have caused some higher-graded enforcement cases to go unworked. (Cincinnati and St. Louis Districts)

. Agents in the Criminal Investigation function have been taken off the line to act as managers because vacant management positions cannot be filled. (Midwest Region) That same region noted that about 1/3 of its special agents would be retiring in the next 5 years and that it should already be in the process of hiring and training replacements because it takes about 3 years to get a new agent ready. The hiring freeze has affected the region's ability to do that.

. Because Information Systems cannot hire backups, they do not always have properly trained people to fill positions. (Kansas City Service Center)

. The presence of 22 vacant tax examiner positions and 3 vacant group manager positions contributed to a significant increase in the number of overaged cases in the Automated Collection Site's inventory and caused the site to curtail sending letters to taxpayers for whom they had no phone numbers. (Indianapolis Call Site)

Mr. ANTHONY [presiding]. Mr. Rhile, you are recognized.

STATEMENT OF HOWARD G. RHILE, JR., GENERAL GOVERNMENT INFORMATION SYSTEMS ISSUES DIRECTOR, INFORMATION MANAGEMENT AND TECHNOLOGY DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY TIMOTHY P. BOWLING, SENIOR ASSISTANT DIRECTOR, AND HAZEL E. EDWARDS, ASSISTANT DIRECTOR, INFORMATION MANAGEMENT AND TECHNOLOGY DIVISION

Mr. RHILE. Thank you, Mr. Chairman.

I would like to introduce my colleagues. On my right is Mr. Tim Bowling, and to his right, is Ms. Hazel Edwards.

I will read my full statement, which is short.

First of all, I would like to express my pleasure at being here to discuss IRS' progress in modernizing the computer systems that process tax returns. As you requested, we will discuss the challenges that IRS is facing in the TSM program—the tax system modernization—and describe the progress of two early modernization projects: the electronic filing and the online entity systems.

And, finally, we will make some comments on the recent budget cuts that IRS has sustained in the ADP area.

Now, as you know, the IRS still processes tax returns using design concepts from the 1950's, such as batch processing and magnetic tape storage on reels.

The system relies very heavily on paper-driven, labor-intensive processes. And as shown in the chart to my right, airplanes and trucks are used to move information across the country, instead of modern telecommunications.

As a result, data input and retrieval often take weeks, making service to taxpayers slow and sometimes unreliable. Tax system modernization may well be the largest and most costly civilian modernization the government has ever undertaken.

As shown in this chart, now, it is intended to capture and store tax returns in electronic form and move it electronically around the country to wherever and to whomever needs that information.

Since 1986, IRS has spent about $120 million on this system and it is estimated to cost several billion dollars more and take the greater part of a decade to complete.

As pointed out in our recent report, this is IRS' third major modernization attempt since 1968. The earlier efforts were unsuccessful, largely due to a lack of stable leadership, a lack of accountability for them, and a lack of technical and managerial expertise.

Although considerable progress has been made with the current modernization effort, it also is beset with some uncertainty. As discussed in the report I just referred to, IRS still needs to articulate precisely what TSM is, how it will benefit the taxpayer, and the plans and the schedules for making TSM a reality.

For example, is it the beginning of a new way of doing business that would change dramatically how IRS services the taxpayer or is it intended to lower costs and increase the efficiency of current operations?

The uncertainty is further illustrated by the continual changes in the number and scope of TSM projects identified in the budget from year to year.

Finally, the lack of a master plan for TSM makes it very hard to know whether and how the different systems will fit together into an integrated whole. For example, does TSM include a telecommunications network? If so, then why is not such a network included among the budgeted projects?

Now, to enhance the prospects of TSM's success, there are a number of things that we pointed out in our report, that we believe that IRS needs to do.

First, IRS must have a very clear vision of its business goals in terms of improving service to the taxpayers and improving IRS' operations. Then it must know how TSM will meet those goals.

It must marshal the very best technical and managerial talent available to overcome the problems that it continues to experience in developing its major systems.

The best talent must also be brought to bear on defining the technical platform: the hardware, the software, the information bases needed to achieve TSM's goals. It must also be brought to bear in making the major decisions impacting the design and development of the modernization.

Key leadership, key project management, must be stable and competent, so that the modernization can be carried out without the continued disruptions that IRS currently experiences.

Finally, the Congress must be provided with unambiguous information on the modernization. It is essential that IRS clearly lay out for Congress the business goals for TSM, how the projects that will comprise it will meet these goals, the priority of the projects, their estimated costs and how and when they will be accomplished.

Until IRS can do this, the focus of TSM will continue to be confusing.

Now, at this point, I want to emphasize that the Commissioner and his top managers have demonstrated a very strong commitment to establishing the foundation to make modernization a reality in IRS.

For example, IRS has recently reorganized its technology management structure to provide a single, top manager focal point, the chief information officer, to oversee all of IRS' technology programs.

The Commissioner is also making a concerted effort to involve outside talent, the best available, in key modernization decisions. We are hopeful that these efforts will help to clarify the uncertainties surrounding TSM, but they remain as of now.

Until they are resolved, it will be extremely difficult to assess the progress of TSM. The electronic filing system illustrates the uncertainties of TSM.

This system evolved from an interim project that was first deployed in 1988 on a limited basis. It has since been expanded and is now operational nationwide. As we testified last year, the system did not work as intended in either the 1988 or 1989 filing seasons.

Although the system generally seems to be working well now, and over 3 million taxpayers have used the system as of March 15, 1990, we cannot yet tell whether the system is a success, because it

is unclear how this system meets IRS' business goals for TSM and how it will be integrated into TSM.

For example, is electronic filing ultimately intended to be used by all taxpayers, or just those using paid preparers? What share of the taxpayer's market is IRS after, and by when does it hope to get it? Is electronic filing intended to reduce costs for IRS?

Also, it could cost the taxpayer $15 or more just to transmit a return electronically, and this may discourage some taxpayers from participating.

Until IRS defines the goals of this system as they relate to the overall goals of TSM, it is difficult for us to access whether the progress of the electronic filing system is good or not.

The other project that you asked about, the online entity system, also known as OLE, will allow IRS to validate a taxpayer's identity before sending tax return information to the master files in Martinsburg.

OLE is in the very early stages of a pilot test and we do not anticipate that it will have a major impact this year, but, despite some minor problems, this system seems to be working and providing some benefits.

You also asked about the effect of any 1990 budget cuts on the modernization program. The 1990 IRS ADP budget sustained cuts of nearly $100 million because of sequestration and increased salary costs. These cuts were most visible among non-TSM projects; funds for projects that IRS designated as TSM were not cut in 1990.

This concludes my prepared statement, and I should be happy to respond to any questions that you may have.

[The prepared statement and attached report follow:]

STATEMENT OF HOWARD G. RHILE, DIRECTOR, INFORMATION MANAGEMENT AND TECHNOLOGY DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to discuss the Internal Revenue Service's (IRS) progress in modernizing the computer systems that process tax returns. As you requested, we will discuss the challenges IRS is facing in planning its overall Tax System Modernization (TSM) program and describe the progress of two early modernization projects--the electronic filing and On-Line Entity (OLE) systems. We will also comment on the recent budget cuts IRS has sustained in the automated data processing (ADP) area.

TAX SYSTEM MODERNIZATION:
IRS' CHALLENGE FOR THE 21ST CENTURY

IRS still processes tax returns using design concepts from the 1950s, such as batch processing and magnetic tape storage on reels. The system relies heavily on paper-driven, labor-intensive processes. As shown in the chart before you (CHART I) airplanes and trucks are used to move information across the country instead of modern telecommunications. As a result, data input and retrieval often take weeks, making service to taxpayers slow and sometimes unreliable.

Tax System Modernization may well be the largest and most costly civilian modernization the government has ever undertaken. As shown in the chart now before you (CHART II) it is intended to move tax return information electronically to where and to whom it is needed. Since 1986, IRS has spent about $120 million on its Tax System Modernization program, a major development effort that is estimated to cost several billion dollars and take the greater part of a decade to complete. As pointed out in our recent report[1], this is IRS' third major modernization attempt since 1968. These earlier efforts were unsuccessful largely because of a lack of stable leadership, lack of accountability for them, and a lack of technical and managerial expertise.

Although considerable progress has been made with the current Tax System Modernization efforts, it is also beset with some uncertainty. As discussed in our report, IRS still needs to articulate what TSM is, how it will benefit the taxpayer, and the plans and schedule for making TSM a reality. Is it the beginning of a new way of doing business that would change dramatically how IRS services the taxpayer? Or, is TSM merely intended to lower the costs and increase the efficiency of current operations? Either way, when does IRS plan to complete this modernization? This uncertainty is further illustrated by the continual changes in the number and scope of TSM projects identified in the budget from year to year which make it difficult to understand just what TSM is. Finally, the lack of a master plan makes it difficult to know whether and how the different systems will fit together into an integrated whole. For example, does TSM include a telecommunications network? If so, then why isn't such a network included among the budgeted projects?

To enhance the prospects of its success, IRS must first have a clear vision of its business goals in terms of improving service to the taxpayers and IRS' operations, and how TSM will meet these goals. Once a clear vision is established, IRS must marshall the best technical and managerial talent available to overcome the problems it continues to experience in developing major systems. The best talent must also be brought to bear on defining the technical platform--the hardware, software, and information--needed

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[1]Tax System Modernization: IRS' Challenge for the 21st Century (GAO/IMTEC-90-13, Feb. 8, 1990).

to achieve TSM's goals and make the major decisions impacting the design and development of the modernization. Key leadership and project management must be stable and competent so that the modernization can be carried out without the continued disruptions that IRS currently experiences.

Finally, the Congress must be provided with unambiguous information on the modernization. It is essential that IRS clearly lay out for the Congress the business goals of TSM, how the projects that comprise it will meet these goals, the priority of the projects, their estimated costs, and how and when the projects will be completed. Until IRS can do this, the focus of TSM will continue to be confusing.

I do want to emphasize that the Commissioner and his top managers have demonstrated a strong commitment to establishing the foundation to make modernization a reality in IRS. For example, IRS has recently reorganized its technology management structure to provide a single, top management focal point--the chief information officer--to oversee all IRS' technology programs. The Commissioner is also making a concerted effort to involve outside talent in the key modernization decisions.

We are hopeful that these efforts will help to clarify the uncertainties surrounding TSM, but they remain as of now. Until these uncertainties are resolved, it will be extremely difficult to assess the progress of TSM.

The Electronic Filing System illustrates the uncertainties surrounding TSM.

ELECTRONIC FILING

The Electronic Filing System evolved from an interim project that was first deployed in 1988 on a limited basis. This system has since been expanded and is now operational nationwide, even though fundamental planning is still being reviewed. As we testified last year, the system did not work as intended in either the 1988 or 1989 filing seasons.[2]

Although the system generally seems to be working well this year and over 3 million taxpayers have used the system as of March 15, 1990, we can't tell whether the system is a success because it is unclear how this system meets IRS' business goals for TSM and how it will be integrated into TSM. For example, is electronic filing ultimately intended to be used by all taxpayers or just those using paid preparers? What share of the "taxpayer market" is IRS after and by when does it hope to get it? It could cost the taxpayer $15 or more just to transmit a return electronically. That amount could discourage some taxpayer participation. Is it intended to reduce costs for IRS? Until IRS defines the goals of the system as they relate to the overall goals of TSM, it is difficult for us to assess whether the progress of the Electronic Filing System is good or not.

On-Line Entity

The other project you asked about, the On-Line Entity system, also known as OLE, will allow IRS to validate a taxpayer's identity before sending tax return information to the master files in Martinsburg, West Virginia. However, because OLE is in the early stages of a pilot test, it has not had a major impact this year.

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[2]IRS' Progress in Implementing Its Electronic Filing and Communications Replacement Systems (GAO/T-IMTEC-89-2, Mar. 16, 1989).

Despite some minor problems, the system seems to be working and providing some benefit.

IRS' 1990 ADP BUDGET

Mr. Chairman, you also asked about the effect of any 1990 budget cuts on the modernization program. The 1990 IRS ADP budget sustained cuts of nearly $100 million because of sequestration and increased salary costs. These cuts were most visible among projects aimed at increasing the number of computers and terminals available for responding to taxpayer inquiries and researching problem tax returns. Funds for projects that IRS designated as TSM were not cut in 1990.

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That concludes my statement, Mr. Chairman. I will be happy to respond to any questions you or other members of the Subcommittee may have.

Chart I

GAO Existing Operations

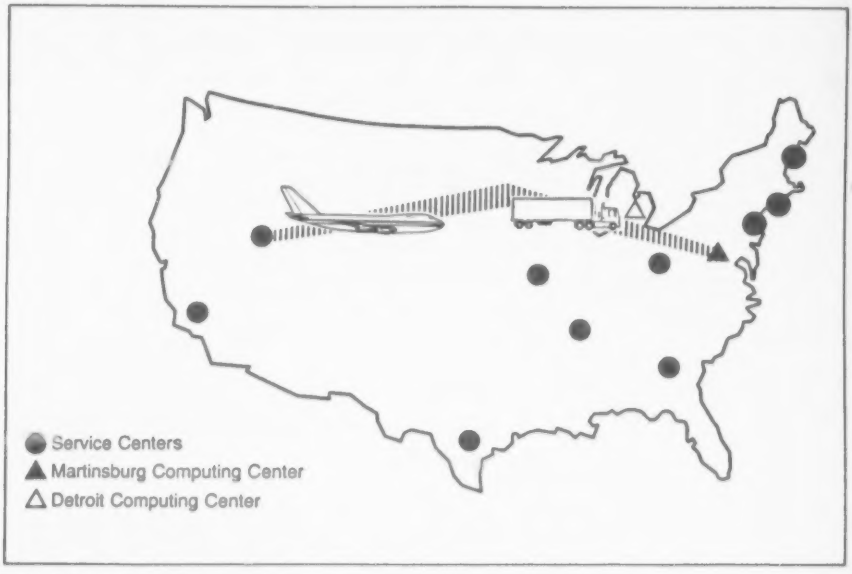
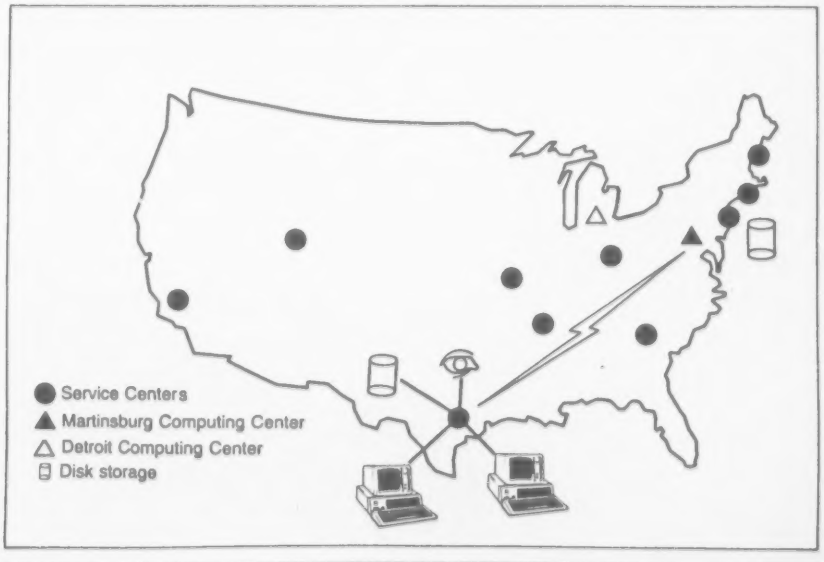


Chart II

GAO Tax System Modernization



United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

February 1990

TAX SYSTEM MODERNIZATION

IRS' Challenge for the 21st Century

GAO/IMTEC-90-13

GAO

United States
General Accounting Office
Washington, D.C. 20548

Information Management and
Technology Division

B-227683

February 8, 1990

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

In response to your September 29, 1989, request, this report discusses the progress of the Internal Revenue Service's (IRS) Tax System Modernization (TSM) program in achieving a fully automated and modernized tax processing system. Specifically, you requested that we assess (1) the extent to which the program will meet its overall goal of improved service to taxpayers, and (2) whether individual components are guided by a strategic plan and have discrete, measurable deliverables.

Synopsis

The modernization program is characterized by high expectations and unanswered questions. IRS has spent about $120 million on TSM since its inception in 1986 and expects to spend several billion dollars more to complete it. Although the program has made significant progress since 1986, the extent of this progress is difficult to measure because the nature and scope of the program has not been clearly articulated. At present, the program is a collection of independent modernization projects, most of which are intended to upgrade existing systems or provide additional computer capacity to meet near-term requirements. While many of these projects should yield badly needed improvements to IRS' tax processing capability, the Service needs to clarify how they will fit together into an integrated system that will meet the agency's needs into the next century. This uncertainty stems in large part from the fact that IRS does not expect to complete its Master Plan for TSM until the Fall of 1990. Without the road map that this plan is intended to provide, it has been difficult for IRS to articulate to the Congress what projects will comprise TSM and how these projects will come together to meet IRS' stated long-range goals for modernization.

The Commissioner has recently demonstrated his commitment to effective management of information technology by creating the position of Chief Information Officer. This presents an opportunity for IRS management to take a fresh look at the status and future of the modernization program. To his credit, the Commissioner is exercising leadership in

refining IRS' vision of the modernization. In the process, he is also seeking to address many of the unanswered questions that have surrounded TSM.

To help in these efforts, this report provides our views on TSM and offers a framework for reducing the risks inherent in this critical and costly undertaking. This framework was reinforced at a recent GAO-sponsored symposium involving leaders from private industry, the executive agencies, and the Congress. IRS participated in the symposium and has enthusiastically supported the management framework. In general, this framework emphasizes the significance of committed leadership, a clearly articulated vision of how technology can be used to enable the agency to achieve its objectives, a concrete plan for implementing this vision that transcends changes in leadership and management, milestones that establish accountability while providing a clear means of measuring progress, and the right people to make the vision a reality.

IRS generally agreed with the accuracy of this report and highlighted its progress in implementing the management framework that resulted from the symposium. IRS also noted four challenges to the modernization beyond those discussed in this report. We recognize these issues as being endemic to most major government modernization efforts and believe that the management framework offered in this report can help IRS overcome these challenges to a successful modernization.

TSM: An Historical Perspective

The IRS tax processing system has remained virtually unchanged since it was automated in the early 1960s. This system processes tax returns using design concepts from the 1950s, such as batch processing and magnetic tape storage on reels. As a result, taxpayers and IRS employees alike have to deal with a tax processing system that relies heavily on paper-driven, labor-intensive processes. Specifically, (1) employees do not have direct access to its master files but must request paper documents, (2) cross-country shipments of magnetic tapes are used to transmit information between computers instead of modern telecommunications, and (3) systems are not integrated to share information. Consequently, data input and retrieval often take several weeks, making service to taxpayers slow and unreliable. IRS expects the volume of tax returns to increase through the 1990s, from 208 million in 1990 to 230 million by 1995; modernizing its tax processing system is critical if IRS is to operate in a world of increasing workloads and limited resources.

Recognizing the limitations of the tax processing system, IRS set out in 1968 to redesign the entire system to take advantage of more advanced technology. This redesign effort was abandoned in 1978 because IRS was unable to resolve congressional concerns about the cost of the redesign and the security of taxpayer information. Another modernization program was initiated in 1982. From 1982 through 1986, IRS pursued three approaches to this modernization, yet none of these progressed beyond the planning stage. These failures resulted in part from repeated changes in leadership at IRS and Treasury, a lack of clear management responsibility for the program, and the need for enhanced technical and managerial expertise within the agency's executive ranks.

Late in 1986, IRS began its third major modernization effort. By March 1988, IRS had approved a management plan that was intended as a basis for modernization. The plan was updated in March 1989. In this update, IRS outlined a modernized environment in which its employees could access all needed taxpayer information directly from computer terminals, thereby providing faster, less costly resolution of taxpayer questions and problems. The agency has indicated to the Congress that the modernization effort, known as TSM, could cost several billion dollars and take another 10 years to complete.

TSM Today: High Expectations and Unanswered Questions

IRS' current modernization approach is surrounded by uncertainty. Making the transition from a tax processing environment based on 1950s design concepts to a state-of-the-art processing environment is neither simple nor rapid. For modernization efforts of this sort to be successful, they must be based upon and directed by a clearly marked road map detailing how the ultimate vision can be achieved. To date, IRS still needs to (1) complete its analyses of how it wants to do business in the future, (2) resolve system integration issues, and (3) identify a clear and consistent set of projects that will comprise TSM. In addition, IRS needs to clearly distinguish between those projects that are primarily intended as near-term improvements to keep the current system operating and those that are designed to meet the modernization's goals. IRS acknowledges that resolving these issues is important to provide the Congress, the Service, and the oversight agencies the information they need to effectively guide the modernization effort.

TSM Will Not Be Fully Defined Until Late in 1990

The status of TSM is difficult to assess in large part because the modernization has not been fully defined. While IRS' 1989 modernization management plan generally describes the objectives for modernizing IRS and

outlines its planning process, the detailed analysis required to implement the modernization will not be available until completion of the TSM Master Plan, currently scheduled for September 1990.

The Master Plan, as currently conceived, will identify the specific IRS functions to be performed, define the automated systems required to perform these functions, describe how these systems will share data, and outline the specific projects needed to implement the modernization. All of these components are necessary to fully define TSM. IRS is currently assessing whether the Master Plan can be completed before September 1990.

TSM Business Assessment Unfinished

An essential step in completing the Master Plan is assessing the business needs of IRS. In other words, before heavily investing in modernization projects, IRS should determine precisely how it will provide taxpayer services and what organizational structure and systems will be needed to deliver these services.

IRS has undertaken a series of business area analyses that are intended to examine the business functions, information requirements, and data structures for each IRS business area. According to IRS' Strategic Data Plan, these analyses are necessary to complete the definition of IRS' business requirements for automated information systems support. The business areas under review include functions such as processing tax returns, reviewing tax returns, and collecting outstanding taxes.

The results of these studies, if adopted, could change the way IRS chooses to conduct business in the future. The agency, for example, may decide to change its organization, or realign the responsibilities of its current organizational units. It is important, therefore, that these studies be completed and considered in planning TSM. The most urgent of these studies are currently scheduled to be conducted while the TSM Master Plan is being developed and may not be completed before the Master Plan is finished in 1990.

In commenting on this report, IRS said that the business area analyses are not critical to the completion of the Master Plan. According to IRS, its Global Baseline User Requirements analysis, Strategic Data Plan, and systems architecture analysis are an adequate foundation for developing systems specifications for the Master Plan. IRS intends to use the business area analyses as a second step, to define detailed requirements for

software specifications. IRS believes that there is risk involved in delaying the Master Plan until the business area analyses have been completed.

While we agree that the business area analyses will be useful in developing systems specifications, we continue to believe that they should also be considered in planning TSM. The three studies IRS cites may not be adequate for TSM planning. First, the Global Baseline User Requirements is an inventory of the information needs of parties inside and outside IRS—ranging from oversight agencies to IRS program offices—that will rely on TSM for analysis, information, and processing functions. This study does not analyze the business functions and data needs of IRS, a necessary step in designing the modernized architecture. Second, the Strategic Data Plan is a high-level document identifying IRS' general business functions and information requirements. It lacks the detail needed to provide a clear picture of how IRS carries out its mission. In fact, the plan highlights the necessity of completing the business area analyses for this purpose. Third, the systems architecture analysis identifies, describes, and evaluates (1) alternate ways that IRS could operate within TSM and (2) the hardware and software architecture needed to support these alternatives. However, it is based upon IRS' existing organization and systems, which may not be structured to take full advantage of the potential efficiencies of modern technology.

In light of the limitations of these studies, it is important that the business area analyses be used in planning TSM. If IRS uses the business area analyses only for defining software specifications, it is foregoing an opportunity to take a fresh look at how it does business and, according to the Strategic Data Plan, risks developing systems that lock IRS into its current way of doing business. Accordingly, IRS should consider their results as early as possible in TSM planning.

System Integration Issues Unresolved

As part of the Master Plan, IRS intends to identify the projects that comprise TSM and describe how the individual projects will be integrated. However, IRS is currently proceeding with several independent projects before demonstrating how they will be connected into an integrated system that will enable IRS employees to share data electronically.

IRS believes that the independent projects now underway will bring sufficient benefits to justify developing them before the integration plans

have been completed. We agree that many of these projects should provide badly needed improvements to IRS' tax processing operations. However, by developing these projects without a clear plan for their integration, IRS risks having to make potentially difficult and costly systems modifications to allow data to be easily exchanged. IRS is working on plans for connecting and integrating the projects that will comprise TSM and will include these plans in the Master Plan.

TSM Projects in Flux

Because IRS has not finished the road map—the TSM Master Plan—the automation projects comprising TSM have been in a state of flux for the last few years. For example, in fiscal year 1990, the modernization program was composed of 17 projects, as compared to 5 projects in fiscal year 1989. In addition, one of the projects that had been identified as part of TSM in 1989 was dropped in 1990. As we testified in April 1989,[1] the renaming, consolidating, splitting, and unclear identification of projects prevented us from tracing projects over previous years.

Plans for fiscal year 1991 reflect further project shuffling. Although fiscal year 1991 information was not officially available from IRS, as of December 31, 1989, agency officials have said that there will be eight projects. Seven projects that were classified as TSM in 1990 will be dropped from the 1991 program, and two new projects will be added. One project appearing among the 1991 projects was excluded from the 1990 projects, but it had been included for 1989. Table 1 shows the shifts in the TSM projects that have occurred from fiscal years 1989 through 1991. Descriptions of these projects are contained in appendix I.

According to IRS, these shifts reflect the needed refinements that are occurring in the Service's definition of modernization as planning progresses. The projects identified for fiscal year 1991, according to IRS, focus on such activities as automating paper tax returns and are activities that would need to be done under TSM regardless of the final design. Unfortunately, the lack of a master plan has made it difficult for IRS to provide a clear and consistent explanation of the relationship between these projects and the goals of the modernization.

[1] Budgetary Implications of IRS' Tax System Modernization and Automated Examination System Efforts (GAO/T-IMTEC-89-4, Apr. 4, 1989).

Table 1: Annual Changes in Designation of TSM Projects

Project[a]	Fiscal Year 1989	1990	1991
Auto Pipeline		x	[b]
Automated Underreporter Project	x		[c]
Automation of Non-Master File		x	
Check Handling Enhancements and Expert Systems		x	[b]
Corporate Files On-Line		x	x
Corporate Systems/Mirror Imaging Acquisition			x
Digital Imaging/Optical Disk Storage System	x	x	[b]
Electronic Federal Tax Deposit System		x	[b]
Electronic Filing Project	x	x	x
Information Systems Development Mission Support	x	x	x
Integrated Input Processing System		x	x
Integrated Telecommunications Network		x	
Local Automation Support		x	
Migration to State-of-the-Art Tape Drives		x	
NCC IBM Interactive Programming/ Remote Job Entry		x	
Optical Character Recognition Replacement System		x	
Service Center Departmental Applications			x
Service Center Systems Acquisition		x	x
Servicewide Citator System		x	
System Integration and Long Term Design	x	x	x

[a]This table is based on budget information that was in effect as of Feb 1988 (fiscal year 1989), Feb. 1989 (fiscal year 1990), and Dec. 1989 (fiscal year 1991). We generally used the most recent project titles and did not show changes in project titles or scope from year to year.

[b]These projects were included in Integrated Input Processing project for fiscal year 1991.

[c]Automated Underreporter was included in the Service Center Departmental Applications project for fiscal year 1991.

TSM Projects Need Re-evaluation

As the above discussion of unresolved TSM issues suggests, IRS is facing a difficult dilemma. On the one hand, the agency must solve near-term problems such as the need to acquire additional computer capacity to support its current tax processing systems. On the other hand, IRS needs to create a fully automated, modernized tax processing system that can take the agency into the 21st century.

The current modernization projects reflect this dilemma. In essence, most of these projects are primarily designed to provide near-term improvements to current operations. For example, one TSM project, the Service Center Systems Acquisition, is designed, in part, to upgrade the computers in the service centers in order to add computer capacity that

IRS considers to be an immediate need; however, this project is also being justified on the basis of its potential function as an integral part of the modernization. Projects such as this may well be worth pursuing, but since TSM will not be fully defined until late 1990, planning and justifying them on the basis of their projected value to the modernization is difficult and risky.

The risks inherent in IRS' approach to TSM are two-fold. First, IRS risks basing a project's justification in part on future benefits that may or may not materialize depending on the final modernization design. Second, if current hardware acquisitions are justified in terms of their possible future role as part of TSM, then IRS risks creating a design to fit the newly-purchased hardware rather than allowing long-range business goals to drive the design. In other words, IRS could be limiting its future options in order to meet near-term needs. The net result of these risks is that IRS may increase its overall costs by making investments before planning is complete, lock itself into a way of doing business that does not fully meet the needs of government and its taxpayers, increase the time required to complete the modernization due to the need for corrective action, and limit competition among vendors to implement the modernization.

IRS needs to determine the extent to which each of the projects currently included in TSM should be justified as modernization investments and the extent to which each should be justified solely on its own merits as meeting critical near-term needs. IRS officials believe that the projects they are currently pursuing are flexible enough to be adapted to the final design. However, IRS has not described the required flexibility or how the projects will be adapted to TSM. In fact, it is difficult to fully assess the risks in IRS' approach until the Master Plan is completed in late 1990. In the interim, because Congressional decision makers must allocate funds based on the expected benefits of projects, it is important that they understand the distinction between those projects that are primarily designed as near-term improvements and those that are designed to achieve the goals of TSM.

Charting the Course: a Framework for Decisionmaking

The federal government has repeatedly found that major modernization efforts such as TSM are extremely difficult and complex undertakings, and fraught with high risks. Many, including IRS' past efforts, have floundered and failed. This costly cycle of failure to meet the needs of our government and our nation's people must be broken.

To explore new ways of meeting the federal government's technology challenge, we sponsored a symposium in October 1989 that brought together concerned leaders from industry, the Executive Branch, and the Congress. These discussions addressed the need for reducing the risk of major modernization efforts and confirmed our views in several key areas. IRS participated in the symposium and has been meeting with us to reconsider TSM in light of these perspectives.

As confirmed by symposium speakers and participants, solutions to modernization problems start at the top. Since the position of Chief Information Officer was recently established in October 1989, this is an opportune time for IRS leadership to reevaluate its modernization activities to ensure that each element of the framework is effectively implemented.

The key to successfully integrating information technology into any agency is the commitment and vision of its leadership. Agency leaders must clearly define their agencies' fundamental missions, understand the needs of the public they serve, and firmly link their information systems plans to these missions and needs. Instead of simply automating old ways of doing business, agencies need to take a fresh look at how technology can best help them accomplish their mission. It is important, therefore, that IRS complete its business assessments, obtain taxpayers' views on how IRS can better serve them, and use the results as the basis for modernization planning. As a general rule, modernization investments should be justified only on the basis of how well they contribute toward achieving IRS' vision of improving taxpayer services and reducing operating costs.

In order to translate the results of its business assessments into a technical "platform" that defines the essential characteristics of the required hardware, software, telecommunications, and information repositories, IRS must forge a partnership between its business and technical managers. These groups must work together to ensure that the platform incorporates the best business thinking with the best technical thinking. The resulting platform should be an integral part of the Master Plan, along with specific milestones that establish accountability for implementation.

It is also critically important that the Commissioner and his top staff surround themselves with the best talent available from government, industry, and academia, and form alliances with these groups to obtain the best possible advice on major modernization decisions. It is also

important that IRS have the right people with relevant experience and accomplishments directing the modernization at all organizational levels.

The lack of continuity at key leadership and project management levels has been a problem in IRS' past modernization efforts. IRS Commissioners seldom serve for more than 2 to 4 years; even career project managers often do not serve for the duration of a project's development. In light of the likelihood of such disruptions, IRS needs to focus on creating a detailed long-range strategy that can transcend changes in leadership or management.

IRS must involve the Congress as an active partner in the modernization effort. As a step in this direction, IRS must clearly articulate to the Congress the business goals to be achieved by TSM and how each project will help achieve those goals. In this respect, IRS must separate the near-term projects needed to continue current operations from those that are more appropriate to the modernization's goals. This will enable the Congress to better evaluate the progress on the modernization and make informed funding decisions. While near-term projects may be appropriate and even critical to IRS' current operations, Congress should understand that they are not part of TSM.

Fully automating and modernizing IRS' tax processing system will result in changes in the way IRS does business—how it is organized, how it uses people, and how it interacts with taxpayers. It is important, therefore, that IRS develop a strategy not only for the modernization, but also for the organizational and personnel changes that modernization will surely bring. It is crucial that the Congress be involved in deciding how best to effect these changes.

TSM may prove to be the largest and most costly civilian modernization effort the government has undertaken. Because this challenge is so enormous, every avenue should be explored to maximize the prospects of its success. One such avenue is phased development whereby each phase produces incremental results that are tangible and build credibility. The increments should fit together as well conceived building blocks, each contributing to the ultimate modernization objective of faster taxpayer service at lower costs. The phased approach also reinforces the partnership with Congress because it provides intermediate checkpoints for assessing TSM's progress and benefits.

The issues discussed in this report illustrate the magnitude of the challenge faced by IRS. It is essential, therefore, that IRS devote full attention

to setting a clear course toward achieving an automated tax processing system that can serve the nation's needs into the next century.

Agency Comments and Our Evaluation

IRS generally agreed with the accuracy of this report, highlighting its participation in the GAO symposium and stressing its commitment to the resulting management framework. IRS believes it is making significant progress in integrating the framework into its management strategy for the modernization. IRS underscored, in particular, (1) the commitment of the Commissioner and top management to the modernization, (2) the recent establishment of a new organizational structure for technology management, (3) the creation of programs to provide training to its executives and to recruit seasoned information systems managers, and (4) concerted efforts to involve interested parties outside IRS in modernization decisionmaking and to forge a partnership between its business and technical units. IRS also stated that it believed the three completed planning analyses constituted an adequate foundation for the Master Plan. (This issue is discussed in the section entitled TSM Business Assessment Unfinished.)

We agree that IRS has demonstrated progress in each of these important areas. However, as IRS acknowledges, the agency will have to show continued progress to ensure a successful modernization. In this regard, IRS should emphasize the issues discussed in this report—completing the business analyses, resolving system integration issues, identifying a clear and consistent set of TSM projects based on the Master Plan, and determining the extent to which each of the projects currently included in TSM should be justified as modernization investments and the extent to which each should be justified solely on its own merits to meet critical near-term needs.

IRS also noted four additional challenges that it believes increase the difficulty of successfully completing TSM:

- the constraints inherent in federal procurement regulations and the contract appeals process;
- the absence of multiyear capital budgeting to ensure commitment of resources over long timeframes;
- the need to resolve issues resulting from the impact of automation on the workforce; and
- the constraints posed by federal personnel and pay regulations in hiring and retaining technically proficient information systems professionals.

We recognize that the additional challenges IRS has pointed out must be met in completing TSM; most major government modernizations face them. The management framework espoused in our recent symposium can be applied by IRS to help meet these challenges, particularly those dealing with mitigating the impact of automation on the workforce and hiring and retaining skilled professionals. Working closely with the Congress to address issues such as these should be part of IRS' strategy for completing a successful modernization.

We are sending copies of this report to the Chairmen, House and Senate Committees on Appropriations; Chairman, House Committee on Government Operations; Chairman, Senate Committee on Governmental Affairs; Chairman, Senate Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service; the Secretary of the Treasury; and the Commissioner of Internal Revenue.

This report was prepared under the direction of Howard G. Rhile, Director, General Government Information Systems, who can be reached at (202) 275-3455. Other major contributors are listed in appendix II.

Sincerely yours,

Ralph V. Carlone

Ralph V. Carlone
Assistant Comptroller General

Appendix I

Tax System Modernization Projects Fiscal Years 1989-1991

This appendix contains descriptions of IRS information systems projects that have at one time been identified as part of Tax System Modernization. We used a number of IRS sources in compiling the descriptions, life cycle costs, and implementation dates. Life cycle costs refer to the total costs of developing and operating a system over the entire time it will be used. This period can extend from 5 to 10 years beyond the implementation date—the earliest date the system is used to process taxpayer information. To avoid including the same information twice in this appendix, we have not provided life cycle costs and implementation dates for those projects that were later merged with other projects.

Auto Pipeline	Automation of the initial processing and transcription of tax returns received in paper form. Merged with the Integrated Input Processing System for fiscal year 1991.
Automated Underreporter Project	Automation of the service center research and analysis efforts to resolve cases in which a taxpayer's reported income does not match information returns filed with IRS. Merged with the larger Service Center Departmental Applications project for fiscal year 1991.
Automation of Non-Master File	Automates subsidiary tax forms and tax information files. Merged with the Manual Accounting Replacement System for fiscal year 1991. Life cycle cost: Not currently available. Implementation date: 1990.
Check Handling Enhancements and Expert Systems	Pilot testing of image technology to combine remittance processing and cash management functions into a single system. Merged with the Integrated Input Processing System for fiscal year 1991.
Corporate Files On-Line	A multiphased project to create and provide access to on-line data bases of taxpayer and tax-related information received from individuals and businesses. Life cycle cost: $250.9 Million. Implementation date: 1990 (Phase I).

Corporate Systems/Mirror Imaging Acquisition	Replacement of mainframe computers at the Martinsburg Computing Center and Detroit Computing Center and subsequent acquisition of computers for the Corporate Files On-Line project. Life cycle cost: Not currently available. Implementation date: 1991.
Digital Imaging/Optical Disk Storage System	Development of a data base for the storage and retrieval of tax returns and tax information documents in image form. Merged with the Integrated Input Processing System project for fiscal year 1991.
Electronic Federal Tax Deposit System	Automated processing of federal tax deposits submitted by employers. Merged with the Integrated Input Processing System for fiscal year 1991.
Electronic Filing Project	Automates the receipt and transcription of individual tax returns filed electronically by tax return preparers. Life cycle cost: $189 Million. Implementation date: 1989.
Information Systems Development Mission Support	Annual staffing costs for the Office of the Assistant Commissioner for Information Systems Development. Since this is a recurring budget item, life cycle costs and completion dates are not applicable.
Integrated Input Processing System	A series of systems, incorporating image technology, for remittance processing, and receiving, processing, and storing tax administration data. Life cycle cost: $1.4 Billion. Implementation date: 1993.

Integrated Telecommunications Network	Renamed Integrated Telecommunications Services for fiscal year 1991. Provides nationwide intercity and local area communications networks. Life cycle cost: $1.8 Billion. Implementation date: 1990.
Local Automation Support	Renamed Field Automation Support for fiscal year 1991. Provides single and multiuser microcomputer and minicomputer systems in regional and district offices, and service centers. Life cycle cost: $418.1 Million. Implementation date: 1990.
Migration to State-Of-The-Art Tape Drives	Replacement of tape drives at the Martinsburg Computing Center with state-of-the-art tape cartridge systems. Life cycle cost: $29 Million. Implementation date: 1990.
NCC IBM Interactive Programming/Remote Job Entry	Renamed Support of Master File Processing for fiscal year 1991. Computer system enhancements at the Martinsburg Computing Center (formerly the National Computing Center—NCC) to provide capacity for all aspects of processing taxpayer account files. Life cycle cost: $40 Million. Implementation date: 1992.
Optical Character Recognition Replacement System	Replacement of the equipment used to optically process paper tax documents filed at IRS service centers. Life cycle cost: $88.1 Million. Implementation date: 1991 (Phase I).

Service Center Departmental Applications	A series of software development and conversion projects for tax administration functions performed in IRS service centers. These include the Automated Underreporter Project, Automated Inventory Control System, and Accounts Maintenance Automation. Life cycle cost: $271.8 Million. Implementation date: 1990 (First project).
Service Center Systems Acquisition	Multiphased computer and local area network acquisition project to support service center automation. Life cycle cost: $2.2 Billion. Implementation date: 1991 (Phase I).
Servicewide Citator System	Provide on-line tax, legal, and procedural reference data base for access by all tax administration employees. Removed from the active project list effective fiscal year 1991.
System Integration and Long Term Design	Contractual assistance in managing the overall design and development of the Modernization effort. Life cycle cost: $485.1 Million. Implementation date: 1997.

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Appendix II

Major Contributors to This Report

Information Management and Technology Division, Washington, D.C.	Timothy P. Bowling, Senior Assistant Director Hazel E. Edwards, Assistant Director William D. Hadesty, Technical Adviser Charles D. Hughes, Evaluator-in-Charge Tamara J. Ealey, Evaluator Norman F. Heyl, Evaluator Daniel T. Mullaney, Evaluator
Boston Regional Office	Pamela Lynn Milligan, Evaluator

Mr. ANTHONY. I would like to thank both of you for your testimony.

I assume you heard the exchange that I had with Commissioner Goldberg about paying rent on a building that they are not in.

Have you all had a chance to look at that?

Ms. STATHIS. We have not looked at that in enough depth. We got information about space problems from two different locations where we were inquiring about the effects of budget cuts.

I assume you were referring to the one in San Francisco?

Mr. ANTHONY. Yes.

My line of questioning would be, is it empty because they do not have enough money because they have shifted allocations to other places, and therefore, they cannot get in telephones and other needed equipment?

And yet, they are wasting rent money by not being able to get into a building.

Now, if anything gets your dander up, to be paying some landlord for a building that you are not using.

Now, asbestos was mentioned today and I did not get a chance to follow up and ask what would be the logical question that one would ask after that.

And that is, why in the world would you ever lease a building that had asbestos in it to begin with?

But I will get into that with him later.

If you had not had time to look at it, would you just look into that a little bit more; that one and any other facility and with this in mind, this policy question in mind, have they made some bad decisions in terms of trying to expand into more rental space?

And then, as a result of budget constraints, they were not able to put the needed and necessary rehabs or equipment into it, so that what they are stuck with now, is paying on a monthly or a yearly basis, a building that they are not utilizing.

And I mean that would be very wasteful and I think if that situation exists either in that one facility or other facilities, it is something that we need to know about.

If you could take a look at that, I would appreciate it.

Ms. STATHIS. We will be following up on that.

I think we received different answers when we asked questions about that space, and I have some similar questions as you are having. I am not convinced that we are yet to the correct, final answer on that.

Mr. ANTHONY. Well, you should not be getting two different answers from one agency. I mean, so the person that is responsible for making those decisions out there, ought to be able to get the controversy resolved and I think it does, it may be minor in looking at that one area, but I think it exemplifies what can happen in a bigger context.

So to that extent it is important.

Your tax examiners, did you take a look at whether or not the tax examiners are working on 1987 tax law cases, presently looking at them?

Is there anybody on your staff looking at that?

Ms. STATHIS. I think you are referring to the example that we have in the attachment to the statement, wherein revenue agents

in one district are working 1987 exams and have not yet been trained in 1987 tax law changes.

Mr. ANTHONY. You found that to be true, that they are working on 1987 cases and had not been trained in 1987 law?

Ms. STATHIS. We did not physically look at the returns to confirm that is the case. But that is what we were told by officials in that district.

Mr. ANTHONY. OK.

I would like to get on a more broad plain, back consistent with what Mr. Rhile was saying.

How does the Oversight Subcommittee get convinced, what evidence can we find and obtain to be shown that there is a proper roadmap to implement the tax system modernization?

I mean your testimony makes an abundance of sense, and you would think that any manager would have already put together the roadmap before they ever went out and bid for a piece of equipment, because number 1, you want to make sure that your equipment satisfies why you are buying the equipment.

I mean you go to any computer store and the first thing that they ask you is, what are you going to do with it? And they will not sell you a piece of equipment until you specify what you are going to do with it.

But what you are telling me is that the Internal Revenue Service has gone off and spent millions of dollars on a piece of equipment and what they do is just complain about how tough it is to buy the equipment without backing up from the very beginning to tell everybody why they want the equipment and what they are going to do with it.

That is pretty startling.

So give me some guidelines and give me some criteria that we can, in future hearings, judge their progress.

How do we find out how that roadmap is being developed?

Mr. RHILE. Well, the master plan for TSM—that is, the plan that is to definitize the projects; describe what the projects are to achieve; describe how they are to be technically integrated; and describe the milestones—is due in September of this year.

I would suggest, I would not presume to make recommendations to the committee, but I would suggest that the committee may wish to take a hard look at that document and ask such questions as what business goal are we achieving with this project?

What are we trying to do with it?

How do the projects comport with the business goals?

These are the kinds of questions that I would suggest that the committee may wish to pursue.

Mr. ANTHONY. Well, would we want to pursue those logically though, while the draft is being prepared, rather than waiting until the final report was sent to us?

Is there not some way that we can monitor this as they are trying to develop the draft master plan?

Mr. RHILE. Well, of course, that is the committee's prerogative and——

Mr. ANTHONY. Well, what would be your recommendation?

How would you go about doing it?

Mr. RHILE. How would I do it?

Mr. ANTHONY. Yes, sir.

Mr. RHILE. I think that I would have some conversations between now and September, and I should think that within a couple of months, although the thing is not written, the essential substance of it should be there.

So I should think that maybe you would first want to ask when will this be done, and sit down and get some information at that point.

Mr. ANTHONY. Do you, based on your current information, think that IRS can successfully implement the TSM?

Mr. RHILE. I think IRS is in the best position that it has ever been, in its history, to do so.

The Commissioner and his top management, as I mentioned in my statement, are firmly, firmly committed to this program.

I think that this type of project, as Mr. Philcox pointed out, is not without risk. There are no guarantees that you can do this.

I think that IRS needs to put the very best technical talent on this, in order to get it done.

Mr. ANTHONY. Do you agree with the Commissioner's assessment that the future operation of the Service is at risk if these things are not adequately and properly implemented?

Mr. RHILE. Well, I think that there is a piece of the tax system modernization that calls for upgrading the computer systems, at the service centers and so forth.

That, of course, could be done without moving forward with all of the other pieces of tax system modernization.

But, as the Commissioner pointed out, or as I think he pointed out, that is not quite the way that the Service would like to go. You may very well be locking yourself into an old way of doing business for longer than you want to be, if you do that.

Mr. ANTHONY. I am going to yield to the Chairman.

Chairman PICKLE. Thank you, Mr. Anthony.

You conducted your own survey on the telephone accuracy and you found some 78 percent of the responses given to the taxpayers were correct.

I am glad that you made that survey because, in general, your figures and the IRS' are much the same; they are very close.

Ms. STATHIS. That is correct.

Chairman PICKLE. But I think it is good for both agencies to have conducted surveys and to see how it shapes up.

Did you find any particular areas where taxpayers were having more problems than in other areas?

Ms. STATHIS. Well, in terms of the taxpayers assisters and their answers to us, which I take your question to be, the lowest response we got was on a question dealing with the estimated tax penalty.

That was a question that relates to whether I would be penalized and, if so, what the amount might be.

Another one that is fairly low relates to self-employment tax. Helping the individual think through how to calculate it and what methods might be used.

Chairman PICKLE. The penalty and self-employment areas, those are the two primary areas that had more difficulty?

Ms. STATHIS. Yes, those were the two lowest questions in our survey.

Chairman PICKLE. All right, that is interesting.

If you have any percentage of figures on that, we would like to have them. I think that is interesting.

Now, you did say that, and earlier this morning I said to Commissioner Goldberg, that even in Boston, where they had the expert system in operation, that their results were well below the national average on accuracy rate.

And he questioned that. As I understand it, it was your finding that Boston was below the national average, is that correct?

Ms. STATHIS. I think it is probably most correct to say that it is about average. Our statistics show it below the national average; 72 compared to 78.

I think that IRS' tests shows it a little above the average. With the differences in estimating, you can probably say it is about average.

We also looked at how much Boston has improved this year, compared to how much other sites have improved. And there too, it is about in the middle; about midrange.

Chairman PICKLE. It is not a big difference, in effect?

Ms. STATHIS. It is difficult to say that the export system is the panacea right now.

Chairman PICKLE. Now, in your statement, you made a comment about the Internal Revenue Service budget for 1991 and indicated that the IRS hoped to gain some $3 billion in revenue for fiscal year 1991.

And you are saying to me that you do not think that is going to happen, is that correct?

Ms. STATHIS. That is correct.

Chairman PICKLE. So their hopes in their budget estimate of gaining $3 billion in 1991 is just not going to happen. It is not realistic in your judgment?

Ms. STATHIS. The plans that they have laid out to accomplish, particularly the management reforms, the areas where they say they are going to redirect staff and collect $2.5 billion, the plans that they have laid out to accomplish that are quite ambitious.

They require people throughout the entire country to be mobilized to do things. They require changes in the way that IRS does business. And while all of those may be good things to do, laudable objectives, it seems to us that they will take a while to accomplish.

Chairman PICKLE. Well, then if they tried to bring this about, and they do have additional personnel, that is just going to help them make up for time that they lost this last year.

So we should be put on notice that $3 billion is not a realistic figure, at this point, unless some big changes can be made. Is that correct?

Ms. STATHIS. That is correct.

Chairman PICKLE. All right.

Now, the GAO found that the IRS telephone assistance is less accessible. You found that this year a taxpayer now has a 55-percent chance of reaching an IRS assister on the first call?

Ms. STATHIS. Yes.

Chairman PICKLE. And that compares with about 69 percent in 1989 and in 1988.

So my question would be, has accessibility declined so that they are not able to get an assister because the IRS did not hire enough personnel?

Ms. STATHIS. They have decreased the number of people who are answering telephones. There are also less telephone lines than last year.

Chairman PICKLE. When you say they have decreased the amount of personnel, are you saying they did not have enough people in there handling the phones?

Ms. STATHIS. They have fewer people.

Chairman PICKLE. So, consequently they got a busy signal on the first call, then?

Ms. STATHIS. That is right and they are also getting more calls, a lot more calls.

Chairman PICKLE. More calls, I wonder why they are getting more calls?

Ms. STATHIS. Probably because people are getting busy signals. It is sort of a vicious cycle. You get a busy signal and you have to call again. And you get another busy signal and you have to call again. And so that is the reason that your numbers jump up.

Chairman PICKLE. Yes, that follows what you just said, of course, and if it is busy that is aggravating. If we are going to give a service, we ought to get people to handle the phones.

Now, last year, you said that the Internal Revenue Service needed to improve the availability of tax forms in walk-in offices, and that this year they seemed to have done a better job.

We notice that there are over 700,000 different back orders. But, overall you have indicated that they are better equipped with forms and have done a better job in that field, is that correct?

Ms. STATHIS. That is correct.

Chairman PICKLE. Can you comment on it further, in what areas are you familiar with?

Ms. STATHIS. Yes.

We go into the walk-in sites to check how many forms are there. We take a list in and check them out. Most all of the sites had most all of the forms. We had the numbers in the statement.

Last year, we had 15 sites that had more than 10 forms missing and we did not find unavailability to be that extensive this year. We are also making telephone and mail orders. We are getting more of those back this year, than we did last year.

We are getting them at about the same speed or in the same amount of time as last year. That does not seem to be much different. We are having more difficulty reaching IRS by telephone to order forms just as we did in the tax law area.

Chairman PICKLE. Well, your testimony indicated that they had done a better job?

Ms. STATHIS. That is correct.

Chairman PICKLE. You had ordered a lot of these forms to see how they responded. I understand that you had ordered 307 items by telephone or by mail this year. Then I asked you how many were not included in the initial shipment received and was told about 81 items. Is that correct? Who would know that?

I was told that it was around 81 items and my question is, did you receive an explanation as to why the IRS did not include these items?

Mr. ATTIANESE. We got an explanation in about 70 percent of those cases. We got an explanation more times this year, than we did last year. That was a big problem last year and they have done a better job this year, but there are still some that we are not getting and not getting an explanation as to why.

Chairman PICKLE. Well, you got an explanation but it was not a full explanation?

Mr. ATTIANESE. No.

In about 70 percent of the items that we did not get, we received an explanation as to why we did not get them. There were still 30 percent of the items that we did not get for which we got no explanation.

Chairman PICKLE. Now, in other words, they can still do a better job and they have got to keep working at it.

Mr. ATTIANESE. It is better than last year, but there is still something to be done.

Chairman PICKLE. Can the GAO give this committee some feeling about the confidence that the American people should have with respect to the budget for this extra computer equipment, the big changes that we have got to make over the next 5 years?

They have requested some $240 million for this next year, perhaps even larger, but totaling over $5.5 billion before completed.

Is this a sufficient amount? Will this accomplish what they set out to do? Are you familiar with their plan and what they hope to do? Have you made any study of that contingency?

Mr. RHILE. Yes.

Mr. Chairman, we have not focused particularly on the budget. What we focused on so far is determining the status of the planning effort and looking at TSM from the standpoint of its management.

And, as we pointed out in our report, the master plan for TSM is due to come out in 1990, September of this year, and the projects have shifted over the years. One year you have 17 and the next year you have 5, and so forth. So it is very difficult for us to say whether that amount of dollars is going to be sufficient or not, until such time as TSM settles down and is defined by IRS.

Chairman PICKLE. I think this subcommittee and the Congress has got to be more diligent in the efforts now to remodernize our IRS equipment.

I think we have got to be more aggressive in this subcommittee and we may ask you to make specific examinations.

As we go from our old number 2 pencil and the yellow pad system over to the computer age and the big changes in the electronic field, this is a very major undertaking.

The report about electronic filing is extremely interesting. Now, that pertains primarily to refunds, and we accept that.

Mr. RHILE. Yes, Mr. Chairman.

Chairman PICKLE. But that is just a straw in the wind. We are going to be able to make great advances in that field, and we should be encouraged about it. But, to do so, we have got to have electronic equipment that functions and that is working properly.

Now, that is not going to be easy for us to finance and I doubt that $5.5 billion is going to be enough. It may be twice that amount before we finish.

Usually we underestimate all of these cost estimates and that is just a fact.

I think that somebody needs to pass judgment on the Internal Revenue Service; is this enough and are you ordering the right thing?

So, we may ask you to be involved in that approach also.

Mr. RHILE. Well, I would be pleased to do that, Mr. Chairman.

Chairman PICKLE. Well, I thank you for that.

And I want to thank you for your testimony. You have helped this committee in making an evaluation of the kind of responses the Internal Revenue Service gives in their taxpayer services, in their availability and their accessibility.

First, it appeared to be that you were being negative about it. But the fact of the matter is that we are making improvements in this field and I think we can continue to do that.

Your cooperation means a lot to us and we are going to be talking to you about these and other approaches, particularly in the field of equipment. I want to get your judgment on that, and we are going to be talking to you again on those questions.

Now, we have other questions we are going to submit to you, with respect to the budget request that they have made, and perhaps in the areas of IRS inventories.

But we will submit those to you in writing and we will ask you to respond to us as quickly as you can because we will be having additional hearings on the IRS this year.

Now, Mr. Anthony, do you have other questions you want to ask?

Mr. ANTHONY. I just have one final question, Mr. Chairman.

And it pertains to the modernization processing system.

Mr. RHILE. Yes?

Mr. ANTHONY. It is my understanding that a major part of the system would be the conversion of paper tax returns and documents to electronic images, so that they can be processed more efficiently, is that a correct understanding?

Mr. RHILE. As of now, that is our understanding, Mr. Anthony.

Mr. ANTHONY. So as long as they do not change their mind like they changed their mind before?

Mr. RHILE. Well, I do not want to give the impression that these changes are flippant changes, but yes, that is the current plan.

Mr. ANTHONY. All right, which just forms the basis of my question; do you know of any business entity or of any other Federal agency that is presently utilizing this type of input processing?

And if so, could you identify them?

Mr. RHILE. Yes.

There are quite a few who are using optical imaging to convert paper into an electronic medium. Our experience though, our knowledge of these types of systems tells us that there are two differences between what IRS is planning to do and what the private firms are doing.

One is, of course, in the volume. IRS' volume is probably going to be a lot greater than some of the larger private businesses.

And number 2, is the complexity. Where a private firm might be scanning a little, like an American Express card that you sign, IRS will be scanning tax returns and attachments to tax returns, which is a lot more complex than that.

So, the state of the art is that this can be done and it is being done quite successfully, but that does not mean that you can walk into Radio Shack and buy a piece of this equipment and put it in IRS.

Mr. ANTHONY. If I hear you correctly, what you are saying is that the state of the art is out there in terms of technology but the IRS, in terms of the complexity of what they are trying to do and the amount of conversion is greater than any experience that you know that is in either any other Federal agency or in the private market, is that a correct summary of what you said?

Mr. RHILE. That is exactly right.

Mr. ANTHONY. So that would be something that we should carefully monitor in terms of how they would be forced to tailor make a conversion for their system to make sure that it is adequate and that it actually works and does not overburden the capacity of whatever system they end up using, is that correct?

Mr. RHILE. Yes.

I think that is an excellent area to focus on.

Mr. ANTHONY. Well, I would just like to join the Chairman and thank you.

Your attachments contain a lot of additional information and I certainly hope that the Commissioner and his staff read and take to heart some of the things that you said because it also highlights some of the areas that we went into in terms of the policy decisions that are going to be made down there.

I think the bottom line simply is with this hiring freeze on and as long as it has been on, and if the Congress keeps giving them more responsibility without the money, as the Commissioner noted, they are going to be forced to make decisions internally that are going to be detrimental rather than positive and that is just choices that they are going to be forced to make.

But I think that you have helped us identify them and maybe clarify some of our thinking in terms of where our oversight responsibilities should go.

So, as one Member, I thank you also, for your contribution.

And I yield back to you, Mr. Chairman.

Chairman PICKLE. I am going to declare this committee in recess but I do want to thank you for your testimony.

And we are going to keep in close touch with you. I was not here when you had the explanation about your tax system modernization and your analysis and expectations of what will happen over the years.

Obviously, we are going to make big improvements in the electronic filing system. We will get away from the day when we will have to take all of our tapes and ship them by pony express, or bus, or plane, or truck, or something, and to West Virginia and back and forth.

We will be going to direct electronics some sweet day. And that day will be here just as soon as we can get the equipment in place

to handle it. We cannot handle it today and that is why we do not do it.

But that day is coming though.

So, we had better get prepared for it. And we had better do it as quickly as we can, and we better be willing to pay for it.

And that ought to be understood by the American taxpayers if they want these kinds of changes made, and apparently they do. Every time you say there was a breakdown and you lost some tapes, it is like having a letter lost, and then the American people want to ridicule the system we have got.

We are having to change, and we are beginning to change and we are going to make big changes as soon as the public understands that there is a cost.

I think that we can pay for it, if we have enough personnel in the Internal Revenue Service to actually function properly to bring in the kind of revenue that the American people expect.

So we are making headway and your cooperation with us is appreciated because you help us kind of organize our concerns and give us a lot of facts that we need.

So we thank you and we appreciate your testimony today.

Ms. STATHIS. Thank you.

Chairman PICKLE. The subcommittee is in adjournment.

[Whereupon, at 12:51 p.m., the hearing was adjourned.]

[Additional questions for GAO and their responses follow:]

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May 9, 1990

The Honorable Charles A. Bowsher
Comptroller General
United States General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

I would like to express may appreciation for the testimony of the General Accounting Office (GAO) during the Subcommittee's hearing on the 1990 tax return filing season and the Administration's fiscal year 1991 budget proposals relating to the Internal Revenue Service (IRS).

In follow-up to that hearing, and for inclusion in the hearing record, I request that GAO provide the Subcommittee with a final report (through April 16, 1990) on the availability and accuracy of IRS's telephone assistance program and any difficulties that developed at the end of the filing season. Further, I request that GAO update its testimony on the impact of fiscal year 1990 funding levels on IRS operations in light of IRS's mid-fiscal year review and actions. Please provide this information by May 19, 1990.

Upon submission of this material for the hearing record, GAO will have completed the work requested in my February 15, 1990, letter with the exception of two GAO's reports: (1) the timeliness of Federal tax deposits (on which a final report is expected in mid-July); and, (2) the effectiveness of IRS programs to improve the quality of correspondence, return processing, and notices (on which a staff briefing is expected September 10, 1990).

As always, the Subcommittee appreciates your assistance.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/sa

GAO United States
General Accounting Office
Washington, D.C. 20548

General Government Division

RECEIVED
JUN 27 1990
Ways and Means
Subcommittee on Oversight

June 27, 1990

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

On March 22, 1990, we testified before the Subcommittee on IRS' budget request for fiscal year 1991 and the status of the 1990 tax return filing season. By letter dated May 9, 1990, you asked us to submit for the hearing record follow-up information relating to matters covered in our testimony. You specifically asked for (1) an update on the accuracy of IRS' telephone assistance program, (2) updated information on the status of IRS' current fiscal condition, and (3) information on any difficulties that may have developed at the end of the filing season. The following information responds to that request.

TELEPHONE ASSISTANCE

The results of our review of IRS' telephone assistance confirms the observation we made in our testimony: while IRS improved the accuracy of its assistance this year, taxpayers found it more difficult to reach an assistor. Between March 5 and April 16, we monitored about 700 test calls made by IRS under its Integrated Test Call Survey System (ITCSS) program. ITCSS measures the quality of the answers IRS telephone assistors provide to taxpayer inquiries made on IRS' toll-free telephone system. Under the program, IRS test callers place anonymous calls to IRS assistors nationwide and score their responses to the test questions. Our scores for the 700 calls we monitored agreed with IRS' scores about 95 percent of the time. Given the consistency of these results, we believe that the 77 percent accuracy rate reported by IRS for the filing season is reliable. That rate represents a significant improvement over last year's 63 percent accuracy rate.

Although accuracy improved, the availability of assistance declined and, therefore, taxpayers found it more difficult to reach an assistor. We testified in March that taxpayers had called IRS about 31.5 million times as of March 17 and IRS had answered about 10.7 million of those calls--a 34

percent answer rate. The availability of IRS' assistance in the latter part of the filing season did not improve. As of April 28, IRS had answered about 17.5 million of the 51.0 million taxpayer calls--still an answer rate of 34 percent.

IRS' FISCAL STATUS

On April 20, 1990, IRS issued its revised fiscal year 1990 operating guidelines following a 2-month review of regional financial plans by IRS' Chief Financial Officer (CFO). In those guidelines, IRS (1) relaxed or removed some of the restrictions it had put in place to deal with its fiscal year 1990 funding shortfall and (2) established additional financial controls. According to the revised guidelines, other changes may be made before the end of 1990 because current fiscal projections still show a gap of about $18 million between IRS' estimated needs and available funds.

In a memo transmitting the revised operating guidelines, the CFO noted that the most recent assessment of IRS' financial position revealed labor cost savings resulting from its hiring freeze, promotion restrictions, and productivity gains in the service centers. These savings were to be directed to the following actions in priority order:

(1) removing the restriction on promotion;

(2) increasing clerical staffing up to the October 1, 1989, on-roll levels; and

(3) increasing the level of service associated with the telephone assistance program and the level of effort in the underreporter program.

In addition, certain restrictions on training, equipment acquisitions, and local ADP acquisitions were lifted. For example, IRS deleted its requirement that continuing professional and managerial training be provided at no cost. Further, regional commissioners and other financial plan managers may now delegate authority to their program and functional directors for approval of local ADP and equipment acquisitions within the funds available in their financial plans.

IRS decided to apply the labor cost savings to the above operational priorities even though it still had an $18 million shortfall because (1) the promotion restrictions had adversely affected employee morale (2) the clerical hiring freeze had disrupted field operations, (3) increased telephone assistance is one of the Commissioner's top priorities, and (4) increases in the underreporter program would offset earlier cuts and help IRS realize the revenues it had expected from that program. IRS officials are confident that the remaining $18 million shortfall will be covered through routine contract administration savings and other savings produced by the national office. We will monitor this situation for any further change.

External hiring is still generally frozen in IRS. Some activities, like returns processing and forms distribution have generally been exempted from the freeze since the beginning of the fiscal year; other activities, such as the Automated Collection System call sites and the Service Center Collection Branches were exempted as the fiscal year progressed if their staffing levels were within hiring freeze ceilings. As noted above, the most recent guidelines now allow some hiring of clerical staff and staff working in the telephone assistance and underreporter areas.

IRS' revised guidelines also restricted the reprogramming of future savings in labor cost accounts. Plan managers cannot reprogram funds from labor cost to non-labor cost accounts without national office approval. The CFO wants to be kept informed of these savings which can be used to meet other program commitments Servicewide.

The revised operating guidelines also identified new position management restrictions that are intended to provide better control over labor costs. For the rest of the fiscal year, national and regional offices are restricted from creating or upgrading staff positions (defined as nonsupervisory personnel engaged in nonoperational work) and instituting position classification actions that would affect the upgrade of two or more positions in the same grade and series with comparable duties. Only the CFO or the Chief Information Officer, as appropriate, can make exceptions to these restrictions.

1990 FILING SEASON

We know of no filing season difficulties that arose after we testified. IRS' statistical reports continued to show returns and refunds being processed in a timely manner, service center inventories being kept at levels that IRS considers manageable, and a declining rate of errors on tax returns compared to last year. We are analyzing data on the timeliness of IRS' deposits of tax payments received during the peak filing season. As noted in your letter, we will be reporting separately on the results of that analysis.

- - -

If you or members of the Subcommittee have additional questions, please call me at 275-6407.

Sincerely yours,

Jennie S. Stathis

Jennie S. Stathis
Director, Tax Policy and
Adminstration Issues

APPENDIX

FILING SEASON REPORT

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

MAY 23 1990

RECEIVED

MAY 31 1990

Ways and Means
Subcommittee on Oversight

Beth Vance
Staff Director
Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Beth:

Enclosed is information the Chairman requested on the 1990 filing season, with comparable information on the 1989 filing season. It is the thirteenth and last weekly report.

Filing season information includes the following:

A. Service center data on individual returns received and processed; individual returns electronically filed; a report on refunds certified by the National Computer Center; workload inventories and inventory age reports for adjustments, unpostables and error resolution, as well as entity, rejects, unidentified remittance, block out of balance, underreporter branch correspondence, and taxpayer error trends.

B. Telephone taxpayer assistance data, including statistics on the level of service, weekly reports and a cumulative report on the number of calls answered, overflows and abandoned calls, and a report on telephone equipment failures causing Automatic Call Distributors system downtime.

C. Forms availability data at the distribution centers, including back orders, the reasons for them, average turnaround time, and results of our quality assurance testing of the forms distribution centers.

D. National Office Command Center data on incidents of critical problems for both service centers and automated collection system call sites, including descriptions of the 1990 critical problems.

Please note that the Integrated Test Call Survey System accuracy rates are not included, since we did not maintain such statistics beyond April 21. As requested, we have submitted a report on the underreporter program to show the age of the correspondence.

If you have any questions or need further assistance, you can call Michael Black (566-4359) or Elaine Sierra (566-4658) of the Legislative Affairs Division.

Sincerely,

Gayle Morin
Assistant to the Commissioner
(Legislative Liaison)

Enclosures

cc: Mike Superata

INDIVIDUAL INCOME TAX RETURNS RECEIVED AND PROCESSED

Returns Received and Processed in Service Centers through April 28, 1989 and April 27, 1990. (In Thousands)

1. Weekly		1989	1990	Percent Change
a) Receipts:	1040	2,760	2,229	-19.2
	1040A	587	398	-32.2
	1040EZ	619	549	-11.3
	Total	3,966	3,176	-19.9
b) Processed:	1040	4,226	4,287	1.4
	1040A	879	853	-3.0
	1040EZ	968	942	-2.7
	Total	6,073	6,082	0.1

2. Cumulative From January		1989	1990	Percent Change
a) Receipts:	1040	64,142	67,339	5.0
	1040A	18,336	17,792	-3.0
	1040EZ	19,136	19,122	-0.1
	Total	101,614	104,253	2.6
b) Processed:	1040	39,403	42,955	9.0
	1040A	14,861	14,590	-1.8
	1040EZ	16,134	16,454	2.0
	Total	70,398	73,999	5.1

Note: Data includes electronic returns.
{PgUp}

Individual Income Tax Returns Electronically Filed April 26, 1990

	Cincinnati	Ogden	Andover	Total
Weekly Receipts				
Accepted	3,282	5,352	3,090	11,724
ERS	153	362	149	664
Accuracy Rate	95.3%	93.2%	95.2%	94.3%
Unpostables	1,246	1,338	604	3,188
Cumulative Receipts				
Accepted	1,829,546	1,561,120	794,218	4,184,884
ERS	76,174	82,022	29,566	187,762
Accuracy Rate	95.8%	94.7%	96.3%	95.5%
Unpostables	32,278	28,628	12,706	73,612
Cumulative to date in 1989	.....			1,157,577
1990 increase over 1989	.....			261.5%

REFUND COMPARISON REPORT

Refunds Certified by Martinsburg Computing Center through April 27, 1989 and April 26, 1990. (In Thousands)

1. Weekly	1989	1990	Percent Change
a) Number (Thousands)	4,781	4,475	-6.4
b) Amount of Principal (Millions)	$4,385	$4,187	-4.5
c) Average Refund (Principal)	$917	$936	2.0
2. Cumulative from January			
a) Number (Thousands)	55,215	57,778	4.6
b) Amount of Principal (Millions)	$46,525	$49,952	7.4
c) Average Refund (Principal)	$843	$865	2.6

ADJUSTMENTS (IMF/BMF) 1989 vs 1990

4-27-90

	4/28/89 Inventory	Current Inventory	4/28/89 Cum Rec's	Current Cum Rec's	% Change Invent.	% Change Rec's
ANSC	48,336	47,471	344,600	345,893	-1.8%	0.4%
ATSC	37,834	54,787	382,197	383,212	44.8%	0.3%
AUSC	51,946	59,313	352,752	358,245	14.2%	1.6%
BSC	37,923	33,620	314,964	332,816	-11.3%	5.7%
CSC	59,637	58,411	453,427	421,091	-2.1%	-7.1%
FSC	55,467	41,547	416,301	390,427	-25.1%	-6.2%
KCSC	65,658	60,679	316,663	337,749	-7.6%	6.7%
MSC	66,167	46,671	276,690	281,044	-29.5%	1.6%
OSC	58,011	67,017	372,348	460,084	15.5%	23.6%
PSC	61,566	55,528	366,512	424,127	-9.8%	15.7%
TOTAL	542,545	525,044	3,596,454	3,734,688	-3.2%	3.8%

UNPOSTABLES (*) 1989 vs 1990

4-27-90

	4/28/89 Inventory	Current Inventory	4/28/89 Cum Rec's	Current Cum Rec's	% Change Invent.	% Change Rec's
ANSC	44,499	35,686	334,914	228,091	-19.8%	-31.9%
ATSC	50,067	53,756	342,964	334,100	7.4%	-2.6%
AUSC	54,581	53,092	327,450	279,712	-2.7%	-14.6%
BSC	77,749	53,866	331,172	279,590	-30.7%	-15.6%
CSC	35,730	27,843	354,806	327,111	-22.1%	-7.8%
FSC	49,790	36,013	509,976	501,411	-27.7%	-1.7%
KCSC	46,258	34,764	296,466	269,340	-24.8%	-9.1%
MSC	59,043	41,964	321,829	234,364	-28.9%	-27.2%
OSC	32,364	37,647	313,661	342,137	16.3%	9.1%
PSC	75,360	45,885	337,562	312,869	-39.1%	-7.3%
TOTAL	525,441	420,516	3,470,800	3,108,725	-20.0%	-10.4%

(Inventories are all MFs; Receipts are IMF/BMF)

ENTITY (IMF/BMF/EPMF) 1989 vs 1990 4-27-90

	4/28/89 Inventory	Current Inventory	4/28/89 Cum Rec's	Current Cum Rec's	% Change Invent.	% Change Rec's
ANSC	18,878	14,562	273,459	203,379	-22.9%	-25.6%
ATSC	42,508	16,562	322,731	299,702	-61.0%	-7.1%
AUSC	33,504	24,969	275,586	244,799	-25.5%	-11.2%
BSC	36,553	5,710	249,284	202,482	-84.4%	-18.8%
CSC	16,152	10,544	322,891	292,335	-34.7%	-9.5%
FSC	73,087	32,604	447,681	459,870	-55.4%	2.7%
KCSC	28,464	21,708	312,856	291,645	-23.7%	-6.8%
MSC	38,370	16,820	345,050	226,183	-56.2%	-34.4%
OSC	16,988	21,317	311,413	327,270	25.5%	5.1%
PSC	28,802	29,030	332,825	315,909	0.8%	-5.1%
TOTAL	333,306	193,826	3,193,776	2,863,574	-41.8%	-10.3%

ERS (IMF/BMF) 1989 vs 1990 4-27-90

	4/28/89 Inventory	Current Inventory	4/28/89 Cum Rec's	Current IMF Cum Rec's	% Change Invent.	% Change Rec's	Cur C
ANSC	26,074	2,767	1,028,519	904,030	-89.4%	-12.1%	
ATSC	38,133	23,989	1,119,056	1,015,999	-37.1%	-9.2%	
AUSC	19,219	17,184	1,116,621	1,063,383	-10.6%	-4.8%	
BSC	1,284	5,491	979,582	948,311	327.6%	-3.2%	
CSC	1,306	123	1,738,995	1,694,911	-90.6%	-2.5%	
FSC	3,525	9,267	1,345,354	1,300,631	162.9%	-3.3%	
KCSC	20,824	11,259	1,215,589	1,208,419	-45.9%	-0.6%	
MSC	19,953	4,077	1,204,224	1,086,116	-79.6%	-9.8%	
OSC	1	439	1,157,080	1,224,992	43800.0%	5.9%	
PSC	13,371	4,576	1,290,460	1,340,060	-65.8%	3.8%	
TOTAL	143,690	79,172	12,195,480	11,786,852	-44.9%	-3.4%	1

(Receipts are IMF only)

BOBs (IMF/BMF) 1989 vs 1990

4-27-90

	4/28/89 Inventory	Current Inventory	4/28/89 Cum Rec's	Current Cum Rec's	% Change Invent.	% Change Rec's
ANSC	14,851	14,171	611,036	617,193	-4.6%	1.0%
ATSC	1,834	1,387	631,037	610,053	-24.4%	-3.3%
AUSC	12,783	17,695	724,443	625,595	38.4%	-13.6%
BSC	24,294	12,940	683,691	588,750	-46.7%	-13.9%
CSC	22,928	33,811	1,255,469	911,025	47.5%	-27.4%
FSC	39,885	20,565	1,074,191	880,871	-48.4%	-18.0%
KCSC	4,367	13,691	760,713	737,688	213.5%	-3.0%
MSC	14,272	9,243	677,675	605,434	-35.2%	-10.7%
OSC	27,682	15,692	754,240	593,280	-43.3%	-21.3%
PSC	7,901	4,032	931,520	937,251	-49.0%	0.6%
TOTAL	170,797	143,227	8,104,015	7,107,140	-16.1%	-12.3%

REJECTS (IMF/BMF) 1989 vs 1990

4-27-90

	4/28/89 Inventory	Current Inventory	4/28/89 Cum Rec's	Current Cum Rec's	% Change Invent.	% Change Rec's
ANSC	25,664	17,833	95,109	73,140	-30.5%	-23.1%
ATSC	21,612	22,349	90,099	80,006	3.4%	-11.2%
AUSC	35,113	24,308	97,372	70,025	-30.8%	-28.1%
BSC	20,346	18,484	97,388	76,859	-9.2%	-21.1%
CSC	31,627	24,581	125,475	96,383	-22.3%	-23.2%
FSC	35,442	24,461	118,546	88,508	-31.0%	-25.3%
KCSC	30,516	26,093	98,842	83,208	-14.5%	-15.8%
MSC	29,748	22,597	103,000	67,584	-24.0%	-34.4%
OSC	30,146	27,039	127,637	103,825	-10.3%	-18.7%
PSC	40,241	33,891	106,928	102,336	-15.8%	-4.3%
TOTAL	300,455	241,636	1,060,396	841,874	-19.6%	-20.6%

UNID REMIT 1989 vs 1990

4-27-90

	4/28/89 Inventory	Current Inventory	4/28/89 Cum Rec's	Current Cum Rec's	% Change Invent.	% Change Rec's
ANSC	1,714	1,041	5,261	3,271	-39.3%	-37.8%
ATSC	1,534	1,500	3,116	2,671	-2.2%	-14.3%
AUSC	593	874	873	809	47.4%	-7.3%
BSC	1,971	1,480	4,128	1,887	-24.9%	-54.3%
CSC	993	1,045	3,045	2,694	5.2%	-11.5%
FSC	3,128	2,444	3,983	2,796	-21.9%	-29.8%
KCSC	1,069	1,521	1,072	1,911	42.3%	78.3%
MSC	1,210	1,435	2,851	1,293	18.6%	-54.6%
OSC	740	1,128	2,052	2,050	52.4%	-0.1%
PSC	1,082	1,745	1,280	2,403	61.3%	87.7%
TOTAL	14,034	14,213	27,661	21,785	1.3%	-21.2%

TY87 URP (Cumulative) 4-27-90	ANSC	ATSC	AUSC	BSC	CSC	FSC	KCSC	MSC	OSC	PSC	TOTAL
CP2000s MAILED	247,439	268,586	150,367	301,047	233,458	359,359	258,330	228,889	263,038	266,010	2,576,523
CP2000s TRANS/ASSESS/NO CHNGE/ STAT NOTICES MAILED	191,023	185,134	76,422	256,667	107,751	182,240	156,480	100,042	129,861	177,253	1,562,873
STAT NOTICES MAILED	56,930	75,569	34,063	92,301	34,811	70,051	46,006	42,694	42,551	58,932	553,908
STAT NOTICES TRANS/ASSESS/ NO CHNGE/RESCIND	15,470	5,646	2,061	10,863	2,346	3,679	782	2,344	1,397	3,929	48,517
ASSOC CP2000 RESPONSES	8,527	6,262	15,068	1,465	15,105	12,893	24,753	26,362	6,276	400	117,111
OLDEST REC. DATE	04/09/90	04/16/90	02/26/90	04/09/90	04/09/90	03/30/90	03/28/90	03/12/90	04/06/90	04/16/90	
VOL OVER 30 DAYS	0	0	3,813	0	0	0	0	21,402	0	0	25,215
ASSOC STAT NOTICE RESPONSES	1,536	1,575	2,006	2,609	2,364	3,354	2,391	257	0	275	16,367
OLDEST REC. DATE	04/11/90	04/11/90	03/20/90	04/09/90	04/02/90	N/A	03/28/90	03/26/90	N/A	04/16/90	
VOL OVER 30 DAYS	0	0	741	0	0	0	0	11	0	0	752

PROGRAM ANALYSIS SYSTEM (PAS)-ERROR RESOLUTION SYSTEM (IMF)
PERIOD: 4/19/90 - 4/25/90
MOST FREQUENT TAXPAYER COMPUTER-IDENTIFIED ERRORS

RETURN	ERROR WAS	PERIOD	CUM
1040	DIDN'T FIGURE EARNED INCOME CREDIT	45	387
1040	DIDN'T ENTER AGE/BLINDNESS INDICATOR	42	531
1040A	DIDN'T FIGURE EARNED INCOME CREDIT	40	599
1040EZ	MATH ERROR IN FIGURING REFUND AMOUNT, LINE 8	39	629
1040A	FIGURED EARNED INCOME CREDIT WHEN NOT ENTITLED	36	824
1040A	INCORRECT STANDARD DEDUCTION AMOUNT, LINE 16	34	599
1040	INCORRECT STANDARD DEDUCTION AMOUNT, LINE 34	31	333
1040EZ	DIDN'T USE CORRECT INCOME TO FIGURE TAX, LINE 7	24	385
1040A	MATH ERROR IN FIGURING REFUND AMOUNT, LINE 27	23	501
1040	INCORRECT FILING STATUS USED	22	129
TOTAL MOST FREQUENT TAXPAYER COMPUTER-IDENTIFIED ERRORS		336	4917
TOTAL TAXPAYER COMPUTER-IDENTIFIED ERRORS		1413	20062

Toll-Free Level of Service
Filing Season FY 1990 — National

Week Ending	Actual	Scheduled	Prior Yr	Week Ending	Actual	Scheduled	Prior Yr
1/6	70.8%	75.0%	83.9%	10	72.0%	75.0%	82.8%
13	72.9%	75.0%	85.1%	17	72.0%	75.0%	84.0%
20	72.0%	75.3%	84.5%	24	71.5%	75.0%	82.9%
27	72.4%	75.0%	84.6%	31	71.6%	75.0%	83.0%
2/3	68.9%	75.0%	82.9%	4/7	71.3%	75.0%	81.8%
10	69.1%	75.0%	82.9%	14	70.6%	75.0%	79.0%
17	71.5%	75.0%	84.9%	21	70.7%	75.0%	80.2%
24	70.4%	75.0%	82.4%	28	74.4%	75.0%	80.4%
3/3	71.4%	75.0%	84.1%				
				PP CUM	71.2%	75.0%	82.7%
FP CUM	71.2%	75.0%	82.7%	FY CUM	71.8%	75.0%	83.0%

Toll-Free Telephone Statistics - Overflows
Cumulative

	Filing Season FY 1990 through 4/28/90	Filing Season FY 1989 through 4/29/89
Southeast	8,850,280	3,229,857
Midwest	3,798,490	1,546,690
Central	3,467,957	1,262,117
Southwest	3,576,524	1,529,332
North Atlantic	2,651,379	1,203,144
Mid-Atlantic	4,855,201	2,045,355
Western	5,413,933	1,899,745
International	31,458	6,323
NATIONAL TOTALS	32,645,222	12,722,563

Toll-Free Telephone Statistics - Overflows
Weekly

	Filing Season FY 1990 Week-ending 4/28/90	Filing Season FY 1989 Week-ending 4/29/89
Southeast	200,567	202,951
Midwest	98,915	55,821
Central	83,238	41,239
Southwest	60,559	54,596
North Atlantic	84,258	48,318
Mid-Atlantic	126,788	183,573
Western	225,574	68,316
International	2,017	391
NATIONAL TOTALS	881,916	655,205

Toll-Free Telephone Statistics - Abandoned Calls (Front-line)
Cumulative

	Filing Season FY 1990 through 4/28/90	Filing Season FY 1989 through 4/29/89
Southeast	128,020	245,939
Midwest	136,541	165,971
Central	80,754	113,602
Southwest	97,266	106,257
North Atlantic	169,904	155,629
Mid-Atlantic	169,671	208,298
Western	138,100	215,265
International	1,928	2,360
NATIONAL TOTALS	922,184	1,213,321

Toll-Free Telephone Statistics - Abandoned Calls (Front-line)
Weekly

	Filing Season FY 1990 Week-ending 4/28/90	Filing Season FY 1989 Week-ending 4/29/89
Southeast	7,230	12,066
Midwest	5,647	6,983
Central	3,400	4,736
Southwest	2,995	4,375
North Atlantic	10,878	11,110
Mid-Atlantic	7,501	10,608
Western	6,188	8,058
International	178	174
NATIONAL TOTALS	44,017	58,110

ACD Downtime Comparison
Filing Period
FY89 and FY90
Week 17

Fiscal Year 1989				Fiscal Year 1990			
Site	System	Malfunction/ Downtime 1989	Impact	Site	System	Malfunction/ Downtime 1990	Impact
Dallas	Collins	120 Mins.	One Minute of Calls Lost on Two Processors. (Report Processor Down).			None	

Prepared by: John Tang
Branch: T:T:M
Date: 05/02/90
Wang No.: 2548F
Reviewed by: Jim Jeter

IRS TAX FORMS DISTRIBUTION PROGRAM

There are no major tax items on backorder as of 4-27-90.

QUALITY ASSURANCE TESTING

To acquire data from a representative sample of the wide range of geographical locations, one volunteer from each district, excluding Richmond, Springfield, and Sacramento, is participating in the testing. Two groups of orders are being tested, telephone and order blank (TPOB).

As of April 28, 1990, we have captured data on a sampling of 3,383 orders. The figures below are reflective of this sampling.

- Time required for orders includes the time from the day order was placed to the day order was received.

Eastern Area Distribution Center	Central Area Distribution Center	Western Area Distribution Center	Average
- TAXPAYER ORDERS (Phone and Taxpayer Order Blanks - TPOB)			
15 days	14 days	11 days	13 days
- TAXPAYER ORDERS (Phone Only)			
13 days	11 days	10 days	11 days
- TAXPAYERS ORDERS (TPOB Only)			
18 days	16 days	12 days	15 days
- ALL ORDERS **			
16 days	15 days	12 days	14 days

**Also includes employer and practitioner type orders

NATIONAL OFFICE COMMAND CENTER (NOCC) STATISTICS
1989 VS. 1990

SUMMARY OF CRITICAL PROBLEMS
01/01 THRU 04/28

		1989	1990
NON-ACS			
	Critical:	44	79
	Critical Open:	N/A	1*
ACS			
	Critical:	17	11
	Critical Open:	N/A	1*

Critical is defined as any event which results in a significant work stoppage or processing slowdown.

*As of April 30, 1990, all of these critical problems were closed.

Following is a brief description of the 8 critical problems for the week of April 22 through 28, 1990:

Service Centers:

On April 24, 1990, the Brookhaven Service Center reported a loss of 1 hour of real time due to 2 processing halts on the Unisys 1100.

On April 25, 1990, the link for the On-Line Entity System was down between the Andover Service Center and the Martinsburg Computing Center for approximately 3 hours. This was caused by downed AT&T circuits in the Boston area.

On April 26, 1990, the Philadelphia Service Center reported that air conditioning failure caused a 2 hour loss of real time.

On April 27, 1990, the Ogden Service Center experienced a data check on a disk drive, which brought the Unisys 1100 down for approximately 1 hour and 20 minutes.

On April 28, 1990, the Ogden Service Center reported that a shipment of 6 reels of Generalized Mainline Framework tapes that were being sent to the Martinsburg Computing Center (MCC) had not arrived at Dulles Airport. MCC held up the cycle run until the replacement file was received that afternoon.

Martinsburg Computing Center (MCC):

On April 24, 1990, MCC received an error message on run 460-15-16 due to a bad Social Security Number. MCC reran 460-15, causing run 460-45 to be delayed.

Automated Collection System (ACS) Call Sites:

On April 25, 1990, the Nashville Call Site had a power failure, causing a loss of approximately 3 hours of real time.

On April 27, 1990, the Boston Call Site lost 2 hours of real time when a "diskette check" message was received and processing was stopped. The IBM processor could not read the diskette used for initial program loads. The defective diskette was repaired by IBM.

SUBMISSION FOR THE RECORD

TAXATION SECTION

Committees:
Business Related Taxes
Employee Benefits
Estate Planning/Death Related Taxes
Exempt Organizations
Tax Audits and Litigation
Tax Policy

The District of Columbia Bar

Steering Committee:
Jane C. Bergner, Chair
Collette Goodman
Ellen A. Hennessy
Gerald A. Kafka
Stephen A. Nauheim
Celia L. Roady
Bradley Seltzer
Charles B. Temkin

Robert N. Weiner
Chair, Council on Sections

Jonathan N. Eisenberg
Vice Chair, Council on Sections

Charles F.C. Ruff
D.C. Bar President

Sara-Ann Determan
D.C. Bar President-Elect

Andrew H. Marks
Board of Governors Liaison

Katherine A. Mazzaferri
D.C. Bar Executive Director

Lynne M. Lester
Sections Manager

March 22, 1990

Testimony by the Section of Taxation of the District of Columbia Bar before the House Ways and Means Oversight Subcommittee on Funding for the Internal Revenue Service

The Section of Taxation of the District of Columbia Bar, both as an organization of tax attorneys practicing before the Internal Revenue Service and as concerned citizens, submits as its testimony before the House Ways and Means Oversight Subcommittee[1] with respect to funding for the Internal Revenue Service the following resolution which was approved by the Steering Committee of Section of Taxation on November 15, 1989.[2]

WHEREAS a sound tax system is essential to our democratic form of government and such a sound tax system depends not only upon statutes which are fair, equitable and understandable but also upon the fair and uniform administration of such statutes; and

WHEREAS it is essential that both the President and the Congress of the United States work together in a spirit of bipartisanship to ensure the viability of the Internal Revenue Service, the agency of our Federal government that has been charged with the responsibility of assuring that every taxpayer pays his or her fair share of tax, nor more, no less; and

WHEREAS both the increasing complexity of the tax law and the frequency of changes in such law create greater demands on the limited resources of the Internal Revenue Service and underscore the importance of the Service's ability to (a) provide guidance to taxpayers so that they may comply with and respect our tax system and (b) maintain a capable and efficient staff of field personnel to enforce the tax law; and

WHEREAS the Section of Taxation of the District of Columbia Bar recognizes that, under the Internal Revenue Service's current budgetary allocation, the Service has inadequate resources (a) to service taxpayers to the extent necessary to promote reliance upon and compliance with the tax system, (b) to maintain its level of audit coverage and (c) to utilize, to the extent necessary, collection efforts with respect to increasing accounts receivable;

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[1] The views expressed herein represent only those of the 1,400-member Section of Taxation of the District of Columbia Bar and not those of either the entire District of Columbia Bar or the Bar's Board of Governors.

[2] Copies of the Section of Taxation's resolution have been sent to the Secretary of the Treasury, the Director of the Office of Management and Budget, the Senate Finance Committee, the Assistant Secretary of the Treasury for Tax Policy and the Commissioner of Internal Revenue.

NOW, THEREFORE,

RESOLVED: We urge the executive and legislative branches of our Federal government to join together in taking prompt action to restore to the Internal Revenue Service the funding necessary for the Service to provide to our citizens the levels of assistance and compliance commensurate with our Country's increasing population, the Internal Revenue Service's workload and the frequency and complexity of tax legislation.

Sincerely,

Jane C. Bergner

Section of Taxation
District of Columbia Bar
by
Jane C. Bergner, Chair

Steering Committee
Section of Taxation
District of Columbia Bar

Jane C. Bergner, Chair
Feith & Zell, P.C.[3]

Collette C. Goodman
Shea & Gardner

Ellen A. Hennessy
Willkie, Farr & Gallagher

Gerald A. Kafka
Steptoe & Johnson

Stephen A. Nauheim
Anderson, Hibey, Nauheim & Blair

Celia A. Roady
Ginsburg, Feldman and Bress

Bradley Seltzer
Sutherland, Asbill & Brennan

Charles B. Temkin
Shaw, Pittman, Potts & Trowbridge

[3] All law firm names are for identification purposes only.